

# SMALL BUSINESS INVESTMENT COMPANY REFORM LEGISLATION

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Y 4. SM 1/2: S. HRG. 104-553

Small Business Investment Company R...

## HEARING BEFORE THE COMMITTEE ON SMALL BUSINESS UNITED STATES SENATE ONE HUNDRED FOURTH CONGRESS SECOND SESSION

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MAY 10, 1996



Printed for the Committee on Small Business

U.S. GOVERNMENT PRINTING OFFICE  
WASHINGTON : 1996

26-484 cc

For sale by the U.S. Government Printing Office  
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402

ISBN 0-16-053451-8



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# **SMALL BUSINESS INVESTMENT COMPANY REFORM LEGISLATION**

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**FRIDAY, MAY 10, 1996**

UNITED STATES SENATE,  
COMMITTEE ON SMALL BUSINESS,  
*Washington, D.C.*

The Committee met, pursuant to notice, at 9:30 a.m., in room SR-428A, Russell Senate Office Building, the Honorable Christopher S. Bond (Chairman of the Committee) presiding.

Present: Senators Bond, Bumpers, and Wellstone.

## **OPENING STATEMENT OF THE HONORABLE CHRISTOPHER S. BOND, CHAIRMAN, COMMITTEE ON SMALL BUSINESS, AND A UNITED STATES SENATOR FROM MISSOURI**

Chairman BOND. Good morning. The hearing of the Small Business Committee will come to order. I thank all of you for joining us for this hearing today on the Small Business Administration Small Business Investment Company program.

Senator Bumpers is going to be with us, but he has asked that we go ahead and start without him. As I have told the witnesses, we are going to try to finish by 11 o'clock. But this is a very important subject. It is the third in a series of hearings that I have chaired investigating the successes and problems associated with the program which incentivizes private financial sources to direct important investment capital to America's small business.

I want to go in some depth into where we are and what we are doing to give you a framework of what we hope to accomplish today, because this is really an important step in the drafting of legislation.

We have had a lot of good testimony before this Committee on behalf of the SBIC program. It has been supportive and positive. A number of small businesses have testified about their inability to obtain investment capital from banks and traditional financing firms. They tell us SBICs are frequently their only source of investment capital.

Last year Jerry Johnson, the chief executive officer of Williams Brothers Lumber Company located near Atlanta, testified that not one bank in Atlanta would speak with him about asset based lending. After a lengthy search, he and his partner turned to Allied Capital Corporation, a Washington-based SBIC. Within 60 days, Mr. Johnson was able to conclude his financing arrangement with Allied Capital. Being able to clear this financing hurdle with the help of an SBIC, Mr. Johnson's company has grown significantly, adding employment and increasing its tax base.

Often, we hear major success stories like Federal Express and Callaway golf club company that SBIC funding provided critical capital in their early stages. But it is far more likely that the businesses like the Williams Brothers Lumber Company will be the typical beneficiaries of the SBIC program. These are "Main Street" enterprises located across America who have looked to traditional money sources and been turned away.

The SBIC program is filling this niche, a large niche I must say, that picks up where banks fear to tread and where obviously Wall Street is not interested because the investment size is too small. There are thousands of companies like Williams Brothers Lumber across the country that need investment financing to support growth and new jobs and have nowhere to turn but to the SBIC program to meet their demand for capital.

Leading up to this Committee's hearing last December on "Proposals to Strengthen the SBIC Program," we received a great deal of information about the need to modify the SBIC program. In July Pat Cloherty, chair of SBA's private sector SBIC Reinvention Council, testified on the Council's recommendations to strengthen and expand the program.

Shortly after the hearing, the National Association of Investment Companies, the trade association representing Specialized SBICs and whose current chairman, Terry Jones, we are pleased to have as one of our witnesses today, forwarded to the Committee a copy of their recommendations to improve the SBIC program, which also were submitted to a separate SSBIC Advisory Council organized by SBA.

The report of this SSBIC Advisory Council was expected several months ago, following a December 13 meeting of the Council, according to SBA. Even though the formal report has not materialized, we do expect that that final report will reflect some of the major recommendations contained in the earlier submission by the Specialized SBIC organization.

The involvement of the private sector in analyzing the performance of the SBIC program and the insight provided by these recommendations are commendable and they are very helpful to the Committee. The SBIC Reinvention Council recommended that new fees be imposed to lower the credit subsidy rate so that the program could provide a significant increase in leverage to licensed SBICs. It also recommended certain administrative changes to improve the management and operations of the SBIC program.

The Specialized SBICs recommended that all statutory and regulatory distinctions between SBICs and SSBICs be eliminated, including the deletion of all references to "social or economic disadvantage" from the Small Business Investment Act. NAIC proposed creating a single, combined SBIC program that would retain an important focus on investments in small business at the smaller end of the eligible size standards. They were recommending sensible improvements to make more investment capital available to more small businesses, and proposing to remove the current restrictions that prohibit Specialized SBICs from investing in companies not owned by socially or economically disadvantaged persons.

Most recently, the President's fiscal year 1997 budget request included a recommendation that fees paid by SBICs be increased to



finance a significant reduction in the credit subsidy rate. OMB, recognizing the positive effect of some of the regulatory changes already implemented by SBA, now is using a lower projected default rate, thereby reducing the credit subsidy rate for debenture licensees under the SBIC program.

The Administration's recommendations to lower the subsidy rate even further by increasing fees is very similar to one made this time last year in the amended fiscal year 1996 budget request for the 7(a) Guaranteed Business Loan Program. Last year, this Committee was told by SBA how well the 7(a) program was performing. SBA testified that, if their recommendations to lower the subsidy rate to zero were adopted, the 7(a) program would be put on a firm foundation for many years to come.

Well, unfortunately all of us know the outcome. The Committee reported legislation to raise fees and lower the subsidy rates of 7(a) and 504 programs. The legislation was passed and signed into law in October 1995, which is about the same time SBA and OMB were beginning to work on their most recent budget request, raising the 7(a) subsidy rate by 150 percent and the 504 subsidy rate by more than 650 percent.

Frankly, I think we have to be cautious so that we do not have a problem of this same magnitude under the SBIC program. Based on our experience with 7(a) and 504, I believe the Committee should not approve any decrease in the SBIC subsidy rate by increasing fees without taking the necessary corresponding steps to strengthen the statutory safety and soundness of the SBIC program.

For the past several months, the Committee staff has been working on draft legislation to strengthen and enhance the SBIC program. The draft bill incorporates portions of recommendations made by the SBIC Reinvention Council, the two trade associations representing the SBIC and the SSBIC licensees, and the President's 1997 budget request.

Last week, as many of you know, I asked the Committee staff to circulate a draft bill, the Small Business Investment Company Improvement Act of 1996, and to work with both majority and minority Committee members and their staff, to initiate discussions with SBA and the industry groups to take further steps toward developing a reasonable and generally acceptable set of changes to the Small Business Investment Act that would improve and strengthen the SBIC program.

My objectives in initiating this process include the following: No. 1, to continue to build on the improvements in the SBIC program contained in the law passed by Congress under Senator Bumpers' Chairmanship of this Committee in 1992.

No. 2, reduce the risk of SBIC defaults by putting in place a few important statutory standards governing the licensing and leveraging of SBICs, such as increasing the required level of private capital, eliminating the special distinctions between SBICs and SSBICs, requiring experienced and qualified management for all SBICs, and requiring a level of diversification between SBIC investors and the management team.

Reducing the risk of SBIC defaults by putting in place a few important statutory safeguards governing the operating practices of

SBICs, such as requiring frequent and meaningful valuations and examinations of SBIC licensees and their investments, and setting reasonable limitations on the ability of SBICs with outstanding SBA leverage to further dilute their private capital reserves by incurring additional debt from other sources.

No. 4, emphasize the importance of SBICs making investment in microenterprises, small businesses at the lower end of the eligible size standards, whether or not these investments are made by small or large SBICs.

In this regard, I note with interest that licensees with less than \$2.5 million of private capital, while they represent 38 percent in number of all licensees, provide only 4 percent of the programs private capital. This has been leveraged, by the way, at more than a four-to-one level and I must, therefore, ask questions about the exposures being taken on by SBA. We have done some calculations as well and find that, of all of the SBIC licensees transferred to liquidation since 1989—and there have been 125 of them—92 percent had original private capitalization below \$2.5 million. So more than 90 percent of the liquidation efforts of the SBA were directed at those licensees in the below \$2.5 million range.

The fifth objective is to provide for a reasonable increase in the amount of fees paid by SBICs for their SBA leverage, but more moderate than the proposal made by the Administration, so we can reduce the combined subsidy rate to approximately 6.1 percent, based on the current estimate provided by the CBO.

I took the step of circulating these legislative ideas in the form of a discussion draft in recognition of the very tight timetable under which we have to work in this Committee if we are going to be able to make a difference for program availability and effectiveness for the coming fiscal year. I invite the members of this Committee, their staffs, the SBA, and other interested parties to join in a collaborative and cooperative effort to develop the specific language of workable legislation that assures the future safety and soundness of the program along the lines of the objectives I just mentioned, so that we can see the SBIC program continue to grow and serve increasing numbers of small businesses which need investment capital financing.

The Administration's budget submission for fiscal year 1997 contemplates the adoption of certain legislative changes to the SBIC program, but the actual legislation has not yet been submitted to Congress, even though under typical practice the legislation would accompany the budget submission. Under these circumstances, we are faced with a very shortened schedule since I understand, from the Chairman of the Appropriations Subcommittee, that very shortly they will be marking up the appropriations for the SBA.

So we are going to have to work together, the SBA and the industry groups, and our Committee, to move this discussion draft into a position where it can gain support and provide constructive progress in this area. We have to avoid any further delays that might be occasioned in the process or we are not going to have this done in a timely fashion.

Part of this draft bill codifies into statute some of the same standards and practices currently in place under SBA's regulation governing the program. I know human nature, SBA, like any other

Federal agency, as well as the SBIC industry, would prefer to have maximum flexibility without statutory parameters on matters that have to do with the operations of a fairly complicated financing program like this one. I would hope that this legislation, when completed, will not limit the exercise of reasonable agency discretion in any way that causes unintended consequences or problems for SBA or for the investment professionals who make the program work.

But I call on the SBA and the industry participants to recognize that, as members of this Committee, we have an obligation to the taxpayers whose money is being spent on this worthwhile program, to authorize the program with adequate ground rules in place that are specific and certain enough to assure that the program can reach its objectives and that unexpected and unpleasant surprises, like those that have surfaced in the 7(a) and 504 programs can be avoided.

One area in which I am particularly interested is some ideas on how we can come up with a workable solution on how to apply new requirements to existing licensees. We have no desire to disrupt reasonable expectations of small but capable SBICs who are doing the job now and can continue to do the job. I want the final version of this bill to make a place for them.

What will require some thought and creativity is how to draft this in such a way that we do not unduly hinder the progress SBA has started. We want to continue cleaning up the program of licensees whose continued participation is not beneficial to the health of the program and serves to increase the cost of leverage for other licensees, thus making financing for more small businesses even more expensive.

We are fortunate today to have probably the best panel of witnesses we could get from SBA and the private sector, who should be able to comment on this draft legislation. We look forward to having you propose other changes to improve the SBIC program. If there are others who feel that they have comments as well, we would certainly welcome those in writing or by telephone, by fax, or by e-mail. We want to take all of these comments and suggestions into consideration and will ask the staff to convene whatever drafting sessions or discussion sessions may be necessary to propose a revised draft of this bill next week. We want to stay on target to mark up the bill on May 22. The message is: "The door is open, the windows are open, the lights are on, the work is under way, so let us get on with it and see what we can accomplish."

Now acting in the stead of our ranking minority member is one of the most faithful members of the Committee, and I would like to turn to Senator Wellstone for his opening comments.

#### **OPENING STATEMENT OF THE HONORABLE PAUL WELLSTONE, A UNITED STATES SENATOR FROM MINNESOTA**

Senator WELLSTONE. Thank you, Mr. Chairman. To the panelists and to the Chairman, it has been a real honor serving on this Committee, both with Senator Bumpers and with you, Senator Bond. I want to apologize. I have to leave in less than 10 minutes because I am scheduled interviews, radio interviews, and on my way back to Minnesota.

But I am extremely interested in the hearing. I would thank each of you for coming and I will read your testimony.

Mr. Chairman, I want very briefly to respond to this discussion draft. There are five SBICs operating in my State of Minnesota and they are an important source of venture capital. I could brag about each one of them. It has been a success, but I want to express a few concerns I have about the draft. As you said, hopefully the door is open, and this will be the beginning of good discussion and good work together. We have done a lot of good work together on this Committee, and I appreciate very much your leadership.

Mr. Chairman, in February and April of this year, Piper Jaffray Healthcare Capital of Minneapolis, a new SBIC which was licensed in 1994 after some of the reforms that we passed in this Committee took effect, you were very involved and Senator Bumpers deserves a lot of credit for some of the work on this, paid the SBA and the American taxpayers \$260,000 in profit. A huge success. That was to the taxpayers. Piper Jaffray's SBIC sold its position in a successful investment. It paid, all together, around \$3 million in principal and interest to the SBA. And it paid \$260,000 in profit. That was the taxpayer's share of the SBIC's success.

This is the first time that what we call the participating securities feature of this new SBIC program worked out this way, and it is how the program is supposed to work.

I think in the discussion draft my concern is that the provision that made this possible is not there. I do not want to see that lost. So I want to raise that concern and we may get to that in the discussion.

My second point is that my understanding is that what we would see is the withdrawal of licenses for SBICs and SSBICs with less than \$2.5 million in private capital. This step would eliminate about 40 percent of the current investment companies in the program. That is a lot. That is a lot of companies eliminated, Mr. Chairman.

My position, by the way, is not parochial on this because all five SBICs in Minnesota would be fine. They sort of pass this threshold test. But I do not, from a policy perspective, I do not understand the rationale. I mean, after all, the title of our Committee is Small Business Committee and we should be interested in nurturing and promoting small businesses.

I have a couple of other concerns as well, and I know this is just a draft, but I want to at least lay those out on the table since I am not quite sure what the policy rationale is for some of what I have at least seen in this draft. My assumption is that you have drawn together a good panel that is going to focus on this. I am a little frustrated because with this Friday morning Committee hearing I am not able to stay for it. But I want to be very engaged in this, both from the point of view of the success of the Piper Jaffray case and based upon some reforms we passed less than 2 years ago that are working.

I would not want to see what is happening in Minnesota prevented around the country. If it ain't broke, don't fix it. I also have concern about the other provision which I think would eliminate many companies from participation. Again, I can be rather high



ground about this because it would not directly affect Minnesota. But I do not understand the policy rationale for it.

[The prepared statement of Senator Wellstone follows:]

PREPARED STATEMENT OF SENATOR PAUL WELLSTONE  
COMMITTEE ON SMALL BUSINESS  
MAY 10, 1996

MR. CHAIRMAN. I appreciate your calling a hearing on this subject. There are five Small Business Investment Companies (SBICs) operating in my state of Minnesota. They are an important source of venture capital for new small businesses. It is my understanding that we need to move SBIC authorizing legislation through the Committee this year, and I look forward to working with you on that.

The five SBICs operating in Minnesota include two of the largest SBICs in the whole program, and two smaller, Specialized SBIC's (SSBICs). Maybe the Committee will indulge me for a moment while I brag about the fifth Minnesota SBIC which is in between the top and bottom ends of this size spectrum.

Mr. Chairman, in February and April of this year, Piper Jaffray Healthcare Capital of Minneapolis - a new SBIC, licensed in 1994 after the reforms that this Committee put in place took effect - paid the SBA and American taxpayers \$260,000 in profit. That's \$260,000 in profit. To taxpayers. Piper Jaffray's SBIC sold its position in its successful investment. It paid around \$3 million in principal and interest to SBA. And it paid SBA \$260,000 in profit. That was taxpayers' share of the SBIC's success. This is the first time that what we call the "Participating Securities" feature of the new SBIC program worked out in this way, and it is how the program is supposed to work.

The first reason I tell the story is to remind ourselves that it has not been long since our Committee was instrumental in putting into place some significant reforms of the SBIC program. Our former Chairman Dale Bumpers deserves a great deal of credit for that reform. And we have seen some pretty good performance since then, and no serious problems that I am aware of. I'll come to the second reason for telling the Piper Jaffray story in a minute.

Regarding legislation, let me start by saying that I appreciate the Chairman's statement of openness to suggestions about how we might move forward together based on this "discussion draft" of a proposed SBIC bill. This draft would make some significant changes to the program, and quite a few minor changes. My own position at this point is that the program seems to be working pretty well since our reforms. There may be ways to improve it further. I am certainly open to that. I believe we have to do something with fees, in any case. But I do hope that before making drastic changes, we will weigh carefully the fact that we only have a couple of years of record to go on since our reforms, and performance during those years seems largely to have been good.

I would like quickly to mention three question areas that I have about the discussion draft.

First, I note that it would withdraw licenses for SBICs and SSBICs with less than \$2.5 million in private capital. This step would eliminate about 40 percent of all current investment companies in the program. That is a lot. My position on this is not parochial. None of the five

Minnesota SBICs would be disqualified; the Minnesota SBICs and SSBICs all have over \$2.5 million in private capital. But from a policy perspective, I'm not sure I see the rationale.

I hope the witnesses can address this point. Unless we have evidence that the performance of smaller SBICs is definitely poorer - unless they are in trouble, or costing taxpayers a lot of money, or serving small businesses demonstrably less well - I'm not sure I see why we should kick them out merely because they are small. We are the Small Business Committee. We usually recognize that there are virtues in being small.

Second, as I understand the proposal, SBICs with under \$10 million in private capital would not qualify for the "Participating Securities" feature of the program. But if I understand that correctly, then the proposal would disqualify Piper Jaffray - the first SBIC to return a profit to the federal government! Piper Jaffray's SBIC, according to SBA figures, has just \$7.5 million in private capital. So that's the second reason for telling the Piper Jaffray story earlier. I think we need to look at this provision. I don't think we mean to throw a big success story out of this part of the program - unless we don't want taxpayers to share in that profit from a shared investment. I doubt that is the case.

Third, and finally, I have questions about the fate of current SSBICs in the proposal. As I understand it, SSBICs with private capital of between \$2.5 million and \$5 million would be allowed to stay in the program. They could become SBICs, dropping the first "S" because "Specialized," SBICs would be eliminated. That is the first issue concerning SSBICs, obviously, their elimination. This would end the special directing of venture capital to businesses with economically or socially disadvantaged owners. I don't believe it has been very thoroughly discussed. I am not sure of my position at this point, even if most current SSBICs are prepared to accept it, if indeed that is the case.

The second issue on current SSBICs concerns the ones who qualify to remain in the program as SBICs, but as smaller SBICs. The issue in this proposal is the requirement that these smaller SBICs could invest only in a new category of small businesses called "microenterprises." My first reaction is that I am a big supporter of SBA's Microloan program, and if we do something like this I think we should probably not confuse the programs by using the term "microenterprise." That is a point merely about nomenclature.

More substantively, I again am not sure I see the policy rationale. Why require only smaller SBICs to invest only in very small companies? Why 100 percent? I'm not sure that is really a good idea from a portfolio perspective. It might even be unsound investment policy. Maybe our witnesses can address this point, also. My principal concern is the idea that we would impose a 100-percent requirement on these smaller SBICs' investment decisions, and only a 25-percent requirement on the larger SBICs' decisions. I'm open-minded, but I don't see any particular rationale for that difference.

Mr. Chairman, I hope you will take these remarks as I intend them - as constructive observations. I certainly look forward to working with you on legislation concerning this program. I am confident we can report a bill according to a timetable that you are comfortable with.

Chairman BOND. Thank you very much, Senator Wellstone. We are not going to change the participating feature that you made in your first point, about turning over the profits. That is not going to be changed.

With respect to the small SBICs, were you here when I mentioned the impact of those small SBICs? Our job as a Committee, working with the SBA, is to see that we get the most bang for our buck through the SBA to the small businesses. Our objective is to provide assistance for as many small businesses, through the SBIC program. That does not mean that we are here to foster small SBICs necessarily, unless they do the job.

The 38 percent of the SBICs with less than \$2.5 million in initial capital only make 4 percent of the loans. So that means SBA, in its oversight activity, spends 40 percent of its time working with companies that only do 4 percent of the loans. In addition, of the 125 SBIC licensees that have gone into the liquidation process, and required the liquidation efforts of the SBA, 92 percent of those have been under \$2.5 million.

So our job on this Committee is to ensure that the well-functioning SBICs can continue. But when you look at the mission of getting venture capital to small businesses, you have got a large group of SBICs who provide only 4 percent of the capital, require 40 percent of the ongoing effort, and 92 percent of the liquidation effort. And that is why we have initially proposed looking at that \$2.5 million.

Frankly, are we getting the bang for the buck from the SBA's dollars in that situation. That is the rationale. We are open for discussion and I am sure that our distinguished panels will——

Senator WELLSTONE. Might I respond?

Chairman BOND. Please.

Senator WELLSTONE. I am just looking at my notes because I am a student, I have to learn this as I go along, although I have tried to immerse myself in the Committee's work.

Chairman BOND. Let me point out something I have mistaken. The 38 percent have brought 4 percent of the private capital to this process. They have, on the average, a four-to-one leverage, which is a high degree of leverage, which may or may not have something to do with the inordinate share of the liquidation efforts which has to go forward on this.

Senator WELLSTONE. Two points and then we will get to the panel. My understanding is that almost all of the defaults were prior to the 1992 reforms. That is a point that I want to emphasize. Therefore, the real issue is performance. That is what I think we ought to be focusing on.

The reason I mention Piper Jaffray is that, as I understand the proposal, SBICs with under \$10 million in private capital, would not qualify for the participating securities feature of the program. And if that is the case, then Piper Jaffray would be disqualified. That is my point.

This is the first SBIC to return a profit.

Ms. FORBES. Can I interrupt? Excuse me.

Senator WELLSTONE. Yes, please.

Ms. FORBES. I am sorry, but to clarify here, it is not that Piper Jaffray would be ineligible. They are eligible and in the program



right now. But, if it were a new applicant, it never would have been able to be licensed under the provisions of the bill because there are no exceptions. Our regulations have a \$10 million limit, but they have exceptions.

Senator WELLSTONE. I thank you. Ms. Forbes, again, I am not trying to be parochial. I did not say that well. The point is we would not have other Piper Jaffrays, we would not have other success stories.

Ms. FORBES. Right.

Senator WELLSTONE. Why, when you have got a success story like this, do you want to have a provision that would preclude more of that?

Chairman BOND. This is, I believe I understand, this is your standard, the standard the SBA is applying with exceptions, the \$10 million?

Ms. FORBES. Senator, our regulations do have exceptions but the bill language, at present, does not. That is the point.

Chairman BOND. Maybe we ought to get into the testimony and find out what has happened.

Senator WELLSTONE. Now since I have created chaos and confusion, I am leaving, but I wanted to raise these questions. I will look at the testimony and we will work together.

Chairman BOND. Senator, we always invite people to submit questions for the record. If you have answers for the record, we would be happy to have those as well.

Senator WELLSTONE. I will have answers. I cannot guarantee you will agree with them.

Chairman BOND. Who knows? Well, having that fine start, our fine panel today begins with Ms. Patricia Forbes, the acting associate deputy administrator for Economic Development of the United States Small Business Administration. She is accompanied by Don Christensen, who is the associate administrator. We also have Mr. Harvey Granat, president of Sterling Commercial Capital, Great Neck, New York. Together we have Mr. Terry L. Jones, president of SYNCOM Capital Corporation, Silver Spring, Maryland and Mr. C. Walter Dick, vice president of Pioneer Capital Corporation, General Partner, Pioneer Ventures L.P. 1 and L.P. 2, Boston, Massachusetts.

Patty, if you want to start off and see if you can bring us some enlightenment?

**STATEMENT OF PATRICIA R. FORBES, ACTING ASSOCIATE  
DEPUTY ADMINISTRATOR FOR ECONOMIC DEVELOPMENT,  
U.S. SMALL BUSINESS ADMINISTRATION, WASHINGTON, D.C.;  
ACCOMPANIED BY DON A. CHRISTENSEN, ASSOCIATE AD-  
MINISTRATOR, OFFICE OF INVESTMENT, U.S. SMALL BUSI-  
NESS ADMINISTRATION**

Ms. FORBES. Thank you, Mr. Chairman. I am presenting the testimony on behalf of SBA, so I am presenting on behalf of Don Christensen, myself, and the rest of the agency. Thank you for inviting me to appear before you this morning. I request that my full written statement be included in the record.

Chairman BOND. It will be made a part of the record.

Ms. FORBES. Thank you.

In recent years, the overall SBIC program has been revitalized. As a result, 65 new SBICs have been licensed in the past 2 years, representing \$827 million of private capital. This is equivalent to the total private capital raised by the program in the preceding 15 years combined. As of April 10, 1996, an additional 72 applications were on hand, representing approximately \$1 billion more of potential private capital, which will provide equity and long-term debt to small businesses.

Let me now comment on certain aspects of the Committee's proposed bill. In the limited amount of time the Administration has had to consider the matters of the bill, a number of issues have surfaced that required further study and discussion. I would ask at this time that the agency be permitted to supplement this testimony by letter in the very near future.

Chairman BOND. We would be happy to have your comments and we will continue the discussions with you, I assure you of that.

Ms. FORBES. It is SBA's desire to work together with the Committee and the SBIC and SSBIC industries to fashion legislation for the program that will improve its operation, reduce its cost to the taxpayers and increase the level of equity and long-term debt it can provide to small businesses.

A number of items in the bill seek to codify existing SBA regulations. The agency is pleased that the Committee endorses the safeguards that SBA implemented by regulation in 1994 and 1996 to enhance the SBIC program. The Office of Management and Budget has advised us, however, that codification of these regulations will not result in a further lowering of the applicable subsidy rates for fiscal year 1996 or 1997, and that they have already been reflected in those rates because it is current agency practice.

If such matters are codified, the agency requests that it be done in a manner to allow the agency to establish the criteria under which Congressional intent is to be carried out. This would ensure that the agency would not lose regulatory flexibility needed to respond in a timely fashion to a complex and ever-changing industry.

The agency also supports the Committee's efforts to provide for penalties for non-compliance with regulations, to address the pending size status issue, to allow for program participation of limited liability corporations, and to make various technical corrections and/or amendments.

Of over-arching concern to us, however, are the bill's many retroactive provisions. One perception that has plagued the SBIC program for many years is that the Government is an undependable partner in terms of its regulations and its commitment to SBICs. The 1992 amendments to the Act and the subsequent creation of a more favorable regulatory environment have done much to dispel these concerns.

Unfortunately, many of the changes proposed in the bill, especially their retroactive application to existing licensees, are likely to revive this negative perception of the Government's reliability. This, in turn, will make it more difficult to interest the most qualified groups to participate in the program.

The President's fiscal year 1997 budget for SBICs proposed two basic program changes which are consistent with the recommendations of the SBIC Reinvention Council. First is an increase in the

user fee charged for leverage to 3 percent from the existing 2 percent. And the second is an imposition of a 1 percent or 100 basis point add-on to the interest rates. The Administration's budget recommends fiscal year 1997 program levels of \$400 million for participating securities and \$225 million for debentures, requiring an appropriation of \$21.7 million.

The proposed Senate bill or discussion draft also increases the user fee to 3 percent, but it increases the interest add-on by only one-half as much, or 50 basis points. With these proposed increases, the Administration's proposed \$21.7 million appropriation will provide program levels of only \$260 million for participating securities and \$123 million for debentures.

This is 39 percent less than the President's recommended program level and far short of the program's needs. The Administration's additional 50 basis point add-on beyond that contained in the bill has a negligible adverse impact on projected SBIC profitability and is justified in the increased program levels.

The agency would encourage the enactment of new leverage fees as soon as possible. These new fees will immediately reduce the SBIC subsidy rates and they can be applied to any uncommitted balance left in 1996.

Finally, the agency has serious concerns about the bill's treatment of minimum capitalization. The bill's \$5 million and \$10 million private capital minimums are consistent with current regulations and seem entirely appropriate for new licensees, provided that an exception be included permitting SBA to accept a reduced level of capital for participating securities if the SBICs can demonstrate viability at the lower level. This exception is needed to cover licensees addressing special underserved markets.

While a \$5 million minimum capitalization is entirely appropriate for new licensees where the future successful performance is unproven, a number of existing licensees have already demonstrated economic viability at smaller capitalizations and are effectively serving the program's public policy objectives.

The bill addresses this issue by providing an exception to the minimums for viable existing licensees having at least \$2.5 million in private capital so long as they invest in what SBA's regulations define as smaller businesses. This smaller business alternative would not unduly restrict the investment opportunities for smaller SBICs and certainly helps advance one of the public policy objectives of the program.

The smaller business alternative would be available to 45 licensees. Unfortunately, however, the bill would require the 104 SBICs with private capital of less \$2.5 million to exit the program. This group, constituting 38 percent of all licensees, represents about \$190 million of outstanding SBA guaranteed leverage. The vast majority of this group have demonstrated long-term economic viability.

Forcing licensees with less than \$2.5 million in private capital to exit the program would seem unfair to the affected licensees and would likely result in increased losses to the Government in recovering outstanding leverage. While the stated objective of this provision is to reduce the SBA's workload in administering the licensees and to address concerns as to possible losses from their failures,

SBA's experience indicates that the provision would dramatically increase SBA's oversight demands for many years to come and would result in increased program losses.

SBA currently addresses the credit risk associated with these licenses by requiring a careful credit review before any new leverage is granted and by using a watch list to monitor troubled situations and to help identify possible failures. Current regulations prohibit SBICs with less than \$2.5 million in private capital or \$1.5 million for SSBICs from obtaining new leverage unless they have been profitable for three out of their four last fiscal years and, on average, have been profitable for all such fiscal years.

The agency believes that existing policies adequately protect SBA against unnecessary future losses. It is the agency's view that any statutory provision addressing this issue should be consistent with current regulatory requirements.

Finally, I have attached to my testimony two listings of SBIC licensees affected by this legislation.

This completes my testimony. I appreciate your affording me and Don Christensen the opportunity to present the Administration's views, and we would be happy to answer any questions you may have.

[The prepared statement and attachments of Ms. Forbes follow:]



U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, D.C. 20416

## TESTIMONY OF

PATRICIA R. FORBES

ACTING ASSOCIATE DEPUTY ADMINISTRATOR FOR ECONOMIC DEVELOPMENT

U. S. SMALL BUSINESS ADMINISTRATION

BEFORE THE SENATE SMALL BUSINESS COMMITTEE

MAY 10, 1996

Good morning, Mr. Chairman and Members of the Committee. I am Patricia R. Forbes, Acting Associate Deputy Administrator for Economic Development responsible for directing all of the Small Business Administration's (SBA's) financing and business education programs. I want to thank you for inviting me to appear before you this morning to review certain aspects of the Small Business Investment Company (SBIC) program and to comment on the Committee's proposed legislation (the Bill) and the Administration's legislative proposals for implementing the FY 1997 budget. Accompanying me is Don A. Christensen, Associate Administrator for Investment, who has had a 30-year career operating an SBIC and has managed the SBIC program at SBA since last September.

## PROGRAM OVERVIEW

### INTRODUCTION

SBA's objective in economic development is to create jobs and accelerate the growth of the economy. An important way of achieving this goal is by making capital available where private sources alone are not providing it. To accomplish this, the SBA is a partner with a broad range of private capital sources in meeting the financing needs of America's small businesses.



To increase the availability of *equity capital and long-term debt* to small business concerns, the SBA licenses privately-owned Small Business Investment Companies (SBICs) to make such investments through the SBIC program. SBA supplements, or "leverages", the private capital of these independently-owned and managed venture capital firms through government-guaranteed securities which are sold publicly. The role of SBA in the program is (a) to determine which SBICs to license, (b) to oversee and regulate those licensees, and (c) to arrange for their funding.

SBICs fill an important gap in the financing sources available to small business. Although an active, private venture capital industry has evolved in recent years, most private venture capital firms today are so large that they are unwilling to make investments of less than several million dollars each. *This often exceeds the small business concern's needs and would result in its having to give up too much of its equity. SBICs, on the other hand, are generally smaller than private investment firms, and therefore are willing and able to make investments which are smaller and of more modest potential returns. Furthermore, SBICs are limited by statute and regulation to investing only in small companies, and SBA gives preference in licensing to applicants which specifically address under-served markets.*

In addition to their investments, SBIC managements add value to the small businesses in which they invest by providing advice and counsel. Entrepreneurs will accept this help, since it comes from people who have their own money and reputations at risk in the business and who have had experience with similar situations in other companies they have backed. A significant criterion for licensing in recent years has been the SBA's assessment of the ability of the proposed SBIC management to offer this kind of support.

Over the past 37 years, the program has provided approximately \$13 billion to 78,000 small business concerns in 107,000 separate financings, including an estimated \$1.3 billion in 1995 alone. A private-sector advisory council estimated that these investments helped create more than one million jobs in the manufacturing and service sectors of the economy. Through investments in new technologies, the program has enabled the conversion of scientific discoveries into high-growth businesses. Special support to businesses owned by persons who are economically or socially disadvantaged is provided by Specialized SBICs.

A number of major U.S. companies trace their early financing to SBICs, including Apple Computer, Federal Express, and Intel Corporation, and more recently, America Online, Sun Microsystems, Sybase, Inc., Callaway Golf, and Outback Steak House, as well as thousands of other small concerns throughout the Nation.

Private capital and private management are the foundation of the SBIC program. Since 1986 the funding of leverage has been provided from private sector sources through the public sale of trust certificates with the government's role essentially that of an insurer. SBICs are an outstanding example of a public/private partnership to address under-served capital needs of the Nation's small business.

### ***AN IMPROVED SBIC PROGRAM***

In recent years, the overall SBIC programs has been revitalized with Congressional support and the passage of the Small Business Equity Enhancement Act of 1992, and the implementation of its provisions in the SBA regulations issued in April, 1994.

Until April, 1994, all leverage provided by SBA to regular SBICs had been in the form of long-term loans. The SBA arranges these financings through quarterly public offerings of trust certificates backed by pools of SBIC debentures and guarantees them as to payment of principal and interest. For those SBIC licensees which typically invest in debt securities, with or without equity features, this debt financing represents a well-matched form of leverage since they are receiving interest income from their investments which they can use in turn for the payment of the interest that they owe on the leverage. Such debt financing, however, is a mismatch for the needs of an SBIC that invests heavily in equity securities which, while they might increase substantially in value over time, typically do not generate immediate cash for the SBIC to pay interest on its leverage.

A major achievement of the new program has been the creation of a second form of leverage designed specifically to meet the needs of equity investors. The new leverage is called the "Participating Security" and is generally a limited partnership interest. It is unique in that it provides the Federal government with a share of the licensee's profits in exchange for deferring all payments by the SBIC until its equity investments generate profits.

As with the debenture program, the funds used for the purchase of participating securities are borrowed from private investors in periodic public offerings, with principal and interest guaranteed by SBA. In this case, however, SBA expects to pay interest on behalf of the participating security issuers for five years or more until they achieve cumulative profitability.

A total of 31 SBICs have been licensed to use participating security leverage, including 30 of the new licensees and one older licensee. These 31 licensees have private capital of \$503.3 million, or an average of \$16.2 million each. An additional 35 applications are on hand for SBIC licenses contemplating use of participating securities, including 18 that already have committed private capital of \$267 million. The remaining 17 applicants are in various stages of raising their private capital estimated at an additional \$542 million.

The first open market financing of securities to provide participating security leverage closed on February 22, 1995, at \$73.3 million. Five additional fundings have been held quarterly since, bringing to \$311.7 million the total participating security financing to date.

The first realized gain under the participating security program occurred in February, 1996, when Piper Jaffray Healthcare Capital, a Minneapolis licensee, cashed in one of its investments and distributed \$1.16 million to SBA. This included principal and prioritized payments (equivalent to interest) owed on the participating securities plus \$35,000 in actual profit to the government. In April, Piper Jaffray made another \$2 million distribution which included a \$225,557 profit distribution to SBA, and a second licensee has scheduled a \$4.8 million distribution for mid-May which will include \$290,000 of profit participation for SBA. In addition, four other SBICs have informed us that they will be making initial distributions shortly which will be applied to reduce principal and their accrued prioritized payments. *This is an encouraging sign since it had originally been estimated that such distributions would not occur until five years or more after licensing.*

The new program has stimulated additional interest in debenture leverage as well. In addition to providing venture equity by purchasing common stock, SBICs also provide long-term debt, which often includes equity features such as convertible debentures. Such "debenture" SBICs provide capital for businesses which do not offer the "home run" potential of the emerging growth companies that expect to be able to sell their stock in the public markets, but which



offer a solid "single or double" type of return. These are typically established companies whose owners do not want to go public or which are not really suitable for public ownership because of limited growth potential or lack of investor appeal. The type of long-term expansion financing that they need is not generally available from banks or private venture investors and is an important contribution of the SBIC program.

A total of 55 new SBICs were licensed in fiscal years 1994 and 1995, representing \$827 million of private capital. *This is equivalent to the total private capital raised by the program in the preceding 15 years.* As of April 30, 1996, an additional 72 applications were on hand, representing approximately \$1 billion of additional potential private capital.

As of April 30, 1996, there were 184 active regular SBICs and 87 Specialized SBICs, also called SSBICs. While regular SBICs may finance essentially any business concern that meets SBA's definition of a small business, Specialized SBICs may only finance small businesses which are owned and controlled by persons whose ability to compete in the free enterprise system is hampered by social or economic disadvantages. The 271 active licensees had total *private* capital of almost \$3.5 billion and used \$1.1 billion of SBA-guaranteed leverage, with most of these funds in regular SBICs as shown in the following table:

| <u>Licensee<br/>Type</u> | <u>Number</u> | <u>Private<br/>Capital</u> | <u>Leverage</u>      | <u>Total</u>         |
|--------------------------|---------------|----------------------------|----------------------|----------------------|
| Reg SBIC                 | 184           | \$3.3 billion              | \$864 million        | \$4.2 billion        |
| SSBIC                    | <u>87</u>     | <u>\$205 million</u>       | <u>\$246 million</u> | <u>\$451 million</u> |
| Total                    | 271           | \$3.5 billion              | \$1.1 billion        | \$4.6 billion        |

All of the new licensees, debenture as well as participating security, meet the tough requirements of the new regulations:

- All have been carefully screened, especially for quality and experience of management.

- They have been licensed to use the form of leverage which best matches their investment programs: for those investing in debt securities, SBA offers the traditional debenture leverage. For those making equity investments, the SBA uses the new Participating Security.
- All have private capital well in excess of the \$2.5 million statutory minimum. A larger capital base allows the company to secure stronger management and to have greater diversification of investments.

These are just the characteristics that SBA had hoped to attract: experienced managers backed by strong financing with constructive business plans.

### THE PROPOSED LEGISLATION

Last Friday, SBA was provided with a copy of the Staff Discussion Draft, dated May 2, 1996, of a Senate bill (the Bill) entitled the "Small Business Investment Company Improvement Act of 1996", and several of us were pleased to have the opportunity to meet with staff of this Committee to begin discussions on the Bill that same day. In the limited amount of time the Administration has had to consider the matters in the Bill, a number of issues have surfaced that require further study and discussion, and I would hope to be able to comment on them in the near future. It is SBA's desire to work closely with the Committee and the SBIC/SSBIC industry to fashion legislation for the program that will improve its operation, reduce its costs to taxpayers, and increase the level of equity and long-term debt it can provide to small business.

A number of items in the Bill seek to codify certain provisions of existing SBA regulations. We are pleased with this proposed endorsement of the safeguards that were implemented by regulation published in 1994 and 1996. OMB has advised that the budget baseline assumes these regulations will be fully implemented. Therefore, the codification of these regulations would make no change in the expected performance of these programs and would not result in any further lowering of the applicable subsidy rates, since they have already been incorporated in the recently revised rates.

If these regulatory provisions are codified, the Agency requests that it be done in a manner which allows the Agency to establish the criteria under which the Congressional intent is to be carried out. This would ensure that the Agency would not lose the necessary regulatory flexibility that is required for it to respond timely to a complex and ever-changing industry. In adopting the April 1994 and January 1996 regulations, SBA sought industry comments and made modifications where appropriate to reflect industry considerations. In addition, SBA is prepared to make further modifications to reflect changing circumstances while continuing to meet the statutory provisions designed to ensure the health of the program. It is obviously much more difficult to do this in the face of statutory provisions, which because of restrictive language, preclude such discretionary policy making by the Agency.

In addition, the Agency supports the Committee's efforts to provide for penalties for noncompliance with regulations; to address the pending size status issue; to allow for program participation by Limited Liability Corporations; and, to make various technical corrections and/or amendments. These are generally desirable actions with which the Agency concurs.

One of the Agency's over-arching concerns about the Bill is its many retroactive provisions. One perception that has plagued the SBIC program for many years is that the government is an undependable partner in terms of its regulation of and its commitment to SBICs. The 1992 amendments to the Act and the subsequent creation of a more favorable regulatory environment have done much to dispel these concerns. Unfortunately, the many changes proposed in the Bill, and especially their retroactive application to existing licensees, are likely to revive would seem to give further credence to this negative perception of the government's reliability. This, in turn, will make it more difficult to interest the most qualified groups to participate in the program.

#### ***THE ADMINISTRATION'S BUDGET PROPOSAL***

The President's FY 1997 budget for the SBIC program proposes two basic program changes which were recommended by the SBIC Reinvention Council, a private sector group of venture capital experts. The first is an increase in the user fee charged for leverage to 3% from the previous 2% and the second is the imposition of a 1% (100 basis points) add-on to

the interest rate. The Administration's Budget recommends FY 1997 program levels of \$400 million for participating securities and \$225 million for debentures. This \$625 million overall program level requires an appropriation of \$21.7 million.

The Bill also increases the user fee to 3%, but it increases the interest add-on by only one-half as much, or 50 basis points. On this basis, the Administration's proposed \$21.7 million budget appropriation will provide program levels of only \$260 million for participating securities and \$123 million for debentures, or \$383 million overall. This is 39% less than the recommended program level and is only a slight increase over the FY 1996 level.

The Administration's proposal for a 100 basis point fee has a negligible adverse impact on SBIC profitability. Current applicants for SBIC licenses are typically projecting a return on their investments of at least 20 percent. With two tiers of leverage and a market rate of 7% for 10-year government securities, this generates an estimated return on equity for the SBIC of 29.34% *after deducting the administration's 1% add-on fee*, versus 29.74% if the fee is only 0.5%, a mere 40 basis point difference. Consequently, the Administration believes that the cost of the 1% add-on is quite reasonable relative to the projected SBIC profitability and the need for adequate leverage to support the program's growth.

The Agency would encourage the enactment of new leverage fees as soon as possible. The new fees will immediately reduce subsidy rates and these new rates could then be applied against any uncommitted balance of the FY 1996 appropriation.

#### *LICENSING AND EXAMINATION FEES*

The Bill proposes to insert a provision that examinations "...shall be conducted with the assistance of a private sector entity that has both the qualifications to conduct and expertise in conducting such examinations". SBA has recently published a request for proposals for a study of examinations outsourcing. The Agency is seeking a contractor to perform twelve licensee examinations out of three locations, including a debenture SBIC, a non-leveraged SBIC, and an SSBIC. The deadline for receipt of proposals is June 24, and we expect that a contract can be let within 60 days thereafter. The results of the study should be available and analyzed by the end of calendar year 1996 and SBA should be in a position to evaluate

the possibility of expanding this option at that time. Until the Agency can assess the risks, benefits and equally important, the cost effectiveness of using a private sector entity for examinations, we believe it is inappropriate to legislate its use.

This Committee and the Administration have both continuously expressed interest in reviewing the potential to outsource certain administrative aspects of the SBIC program. The effort noted above is one of several initiatives the Agency has taken in that direction.

### *MINIMUM CAPITALIZATION*

The history of the program has demonstrated that having adequate private capital is critical to maximizing a licensee's probability of success and minimizing SBA's risk of program losses. Generally, the larger capital base not only increases the cushion underlying SBA's credit exposure, but it reduces risk by permitting greater portfolio diversification and enabling licensees to afford the experienced, professional managements which are often required for successful venture capital investing. SBA recognized this in 1994 when it issued the initial regulations governing the participating security program and established \$10 million as the minimum private capital unless the licensee could demonstrate to SBA's satisfaction that it can be financially viable over the long term at a lesser capitalization. (In no case, however, can a participating security SBIC currently be licensed with less than \$5 million of private capital.) Concurrently, the Agency adopted the policy of requiring \$5 million minimum capital for debenture licensees, rather than the \$2.5 million statutory minimum, unless, as with participating securities, the licensee can demonstrate long term viability with a smaller capitalization. The \$5 million debenture minimum was formally incorporated in the regulations on January 31, 1996.

The Bill would establish \$5 million as the minimum private capital for all SBIC licenses, with a \$10 million minimum required if the licensee intended to issue participating securities. This would seem entirely appropriate for new licensees provided that an exception be included permitting SBA to accept a reduced level of capital for participating security licensees, but not less than \$5 million, if SBICs can demonstrate viability at the lower level. This exception is necessary in order to cover licensees addressing special under-served

markets, such as in the North Dakota Small Business Investment Company, L.P., case where SBA granted a participating security license to a community sponsored applicant with just over \$5 million of private capital.

While a \$5 million minimum capitalization is entirely appropriate for new licensees where the future successful performance is unproven, there are a number of existing licensees that have demonstrated economic viability at smaller capitalizations and that are effectively serving the public policy objectives of the program. The Bill addresses this issue by providing an exception from the minimums for viable existing licensees having at least \$2.5 million of private capital so long as they invest only in "microenterprises". The Bill defines microenterprises by incorporating the definition for "Smaller Businesses" found in Section 107.710 of the regulations. (The Administration suggests that the "Smaller Business" term be retained since the term "microenterprise" in this connection will lead to confusion with the microenterprises of the Agency's Microloan program, which typically have 15 or fewer employees.) Adoption of this \$2 million maximum earnings and \$6 million maximum net worth size criteria should not unduly restrict the investment opportunities for smaller SBICs and certainly helps advance one of the public policy objectives of the program.

The Smaller Business SBIC alternative would be available to the 45 licensees with private capital of between \$2.5 and \$5 million which represent total private capital of \$141.5 million and SBA-guaranteed leverage of \$138.8 million. Unfortunately, however, the terms of the Bill would require the 104 SBICs with private capital of less than \$2.5 million to exit the program. This group, constituting 38% of all licensees, represents \$132.7 million of private capital and \$189.5 million, or 17%, of outstanding SBA-guaranteed leverage. The vast majority of this group have demonstrated long term economic viability,

*There are two listings of SBIC licensees attached to this testimony. The first is a list of all SBICs which provides each licensee's date of licensing, location, and the amounts of its private capital and outstanding leverage. The second is a list, by state, of all licensees with private capital of less than \$2.5 million. I have also attached a copy of a map of the United States which highlights the states which would lose SBICs under the proposed minimum capitalization requirements.*

Forcing licensees with less than \$2.5 million in private capital to exit the program would seem unfair to the affected licensees and would likely result in increased losses to the government in recovering on outstanding leverage. The stated objective of this provision is to reduce the SBA's workload in administering these licensees and to address concerns as to possible losses from their failures. To the contrary, SBA's experience indicates that the provision would dramatically increase SBA's oversight demands for many years to come and would result in increased program losses.

Of the 104 licensees with less than \$2.5 million in private capital, 85 have outstanding SBA leverage the terms of which are established by contract. This leverage has up to 10 years remaining until maturity for debentures and up to 15 years for 4% preferred stock. The 3% preferred stock presents special problems since it has no stated maturity at all. Until maturity, SBA would have to work with the licensees in the hope of achieving an orderly winding up of their business and minimizing potential losses on the leverage. It is unlikely to be a cooperative relationship and is likely to require additional staffing to protect SBA's interests.

Of the 104 licensees in the under \$2.5 million private capital category, approximately 66 are 301(d) licensees, or *Specialized SBICs*. The proposed legislation deletes Section 301(d) of the Act and eliminates all references to program features unique to 301(d) licensees. This is consistent with the proposed recommendations set forth in the recently issued draft report of the SBA's Specialized Small Business Investment Company Advisory Council, although it does not include certain future benefits which the Council believes should be extended to existing 301(d) licensees. To the extent that previous 301(d) licensees join the Smaller Business SBIC program, it will utilize their resources to address a broader but still under-served market. However, in fairness to smaller licensees who have served the 301(d) program for many years but do not qualify for the Smaller Business SBIC program, and to protect SBA's creditor interests arising from their leverage, they should be treated the same as existing 301(c) licensees. Also, it will be necessary to address the implications of the proposal on 301(d) licensees which have participated in the 3% preferred stock repurchase program which, among other things, requires continued active investing for a period of five years.

SBA currently addresses the credit risk associated with these licensees by requiring a careful credit review before any new leverage is granted and by utilizing a watch list to monitor troubled situations and provide early identification of possible failures. Current regulations prohibit SBICs with less than \$2.5 million in private capital (\$1.5 million for SSBICs) from obtaining new leverage unless they have been profitable for three of their last four fiscal years and, on average, had been profitable for all such fiscal years. Licensees that do not satisfy these criteria may refinance existing debentures as they mature on a one-time only basis. The Agency believes that existing policies adequately protect SBA against unnecessary future losses. Therefore, it is the Agency's view that any statutory provision addressing this issue should be consistent with current regulatory requirements.

### *SIZE STATUS ISSUE*

In providing that investments by enumerated venture capital type firms in an otherwise small concern shall not affect its size status determination, the Bill appropriately addresses a situation which currently adversely impacts the investment program of a number of licensees, especially those which issue participating securities. SBA is preparing to address the issue on a regulatory basis, but legislative redress would be appropriate since it concerns a fundamental program precept, the definition of what constitutes a "small business" eligible to receive SBIC financing. The Agency would be pleased to offer technical assistance in the drafting of this section in order to assure that it resolves the issue fully.

### *SBIC LICENSING*

The experience of institutional investors in the private venture capital industry has demonstrated that the initial decision to invest in a particular venture firm is the most important single factor in the ultimate success of their investments. Once the decision to invest in a firm is implemented, there is very little that the institutional investor can do to affect the investment results. This experience is analogous to SBA's decision to license a particular SBIC, although SBA does have somewhat more control after licensing in limiting its financial exposure by ceasing to advance leverage and in insuring that the program's public policy objectives are observed. Consequently, SBA has developed a very detailed and deliberative procedure for licensing which involves extensive "due diligence" evaluation of the applicable qualifications and experience of the management team, a detailed analysis of



the proposed plan of operations, an assessment of the need for the licensee, and a legal review of its structure and organization. This takes considerable time since it requires a number of interactions with the applicant involving clarification of unclear points and modifications of the license application in response to SBA's programmatic and legal comments. In addition, in a number of cases the applicant or its attorney may have been unresponsive, even after many months have passed. In fact, we currently have 10 applicants, representing \$157 million of private capital which they claimed had been raised, in a deferred status awaiting their response after three months or more. Under the circumstances, setting an arbitrary time limit on processing a license application, such as the 90 days contained in the Bill, does not seem in the best interests of the program.

During the past year, no SBIC application approvals were deferred based upon leverage availability nor is there any intention to do so in the future.

#### ***REQUIREMENT TO FINANCE SMALLER CONCERNS***

The Bill proposes that as a condition of approval of an application for leverage, the licensee must certify in writing that at least 25 percent of the total number of entities receiving financial assistance will be smaller concerns. As written, the Agency believes this provision will allow for abuse and/or circumvention of its intent. Further, it could result in less financial assistance being provided to smaller concerns than is already required under current program regulations.

Existing regulations require that at the close of each fiscal year, at least 20 percent of the *total dollar amount* of financings extended since April 25, 1994 must have been invested in smaller concerns. If a statutory provision is deemed necessary to address this area, the Agency believes it should be consistent with current regulatory requirements.

#### ***SUBSIDY RATE CALCULATION***

In connection with the Bill's requirements that all fees, interest, and profits that are directly related to the provision of leverage be included in the calculation of a subsidy rate, it should be pointed out that a portion of the user fee payments must be used to cover costs related to the funding, such as printing, legal, fiscal agent, selling agent, trustee, servicing agent and

servicer and are not be available to apply to the subsidy rate. In the FY 1997 subsidy rate model, 30 basis points of the 300 basis point fee are deducted for this purpose.

### *PENALTIES FOR NONCOMPLIANCE*

The Agency has been requested to advise the Committee as to whether any additional statutory language is necessary to establish administrative or criminal liability for false statements and certain serious regulatory violations by SBICs. Present provisions of the Small Business Investment Act (15 U.S.C. 687(c)-(h) and the Federal Criminal Code (18 U.S.C.) provide an adequate framework to satisfy these concerns, but technical amendments are appropriate. For example, an amendment adding SBA to the list of entities covered by 18 U.S.C. 1014 would make the civil penalties provision of FIRREA applicable to false statements made in connection with seeking SBIC assistance. This would provide an alternative and additional civil remedy against persons or entities making false statements in connection with the program. In addition, where necessary, the present framework in the Small Business Investment Act could be expanded to provide increased civil and criminal coverage for false statements made to SBA in connection with the program. The Agency would be pleased to work with the Committee in crafting appropriate provisions.

A second area where penalties might be usefully legislated is with respect to general regulatory violations where currently available remedies tend to be too severe for the infraction. Under existing statutory provisions, Section 315, "Penalties and Forfeitures", of the Small Business Investment Act of 1958, as amended, the Agency has the authority to assess daily penalties for a licensee's failure to meet certain reporting requirements. This provision should be amended to allow SBA to establish appropriate penalties for noncompliance with critical regulatory provisions. Again, the Agency would be pleased to work with the Committee in crafting appropriate provisions.

### *CONCLUSION*

This completes my testimony. I appreciate your affording me the opportunity to present the Administration's views. Don and I look forward to working with the Committee and its staff in crafting legislation that contributes to the further success and soundness of the SBIC program. We would be pleased to answer any questions you may have.

## SBIC Program Licensees with Private Capital of less than \$2.5 million by state as of 5/2/96

| <u>SBIC Name</u>                      | <u>City</u>     | <u>State</u> | <u>Date Licensed</u> | <u>Type</u> | <u>Private Capital</u> | <u>Leverage from SBA</u> |
|---------------------------------------|-----------------|--------------|----------------------|-------------|------------------------|--------------------------|
| <u>ALABAMA</u>                        |                 |              |                      |             |                        |                          |
| Alabama Small Business Investment Co. | Birmingham      | AL           | 05-Apr-88            | SSBIC       | 1,005,000              | 2,000,000                |
| First SBIC of Alabama                 | Mobile          | AL           | 20-Jul-78            | SSIC        | 2,166,700              | 5,950,000                |
| Alabama Capital Corporation           | Mobile          | AL           | 28-Jul-81            | SSBIC       | 1,550,000              | 500,000                  |
| <u>ARKANSAS</u>                       |                 |              |                      |             |                        |                          |
| Small Business Investment Capital     | Little Rock     | AR           | 06-Mar-75            | SBIC        | 1,150,000              | 3,250,000                |
| <u>ARIZONA</u>                        |                 |              |                      |             |                        |                          |
| First Commerce & Loan LP              | Tucson          | AZ           | 19-Oct-90            | SBIC        | 1,012,000              | 1,000,000                |
| <u>CALIFORNIA</u>                     |                 |              |                      |             |                        |                          |
| Calsafe Capital Corp.                 | Alhambra        | CA           | 28-Dec-88            | SSBIC       | 1,510,000              | 1,510,000                |
| Ally Finance Corp.                    | Beverly Hills   | CA           | 04-Jun-82            | SSBIC       | 600,000                | 950,000                  |
| Fulcrum Venture Capital Corp          | Culver City     | CA           | 05-Jul-78            | SSBIC       | 2,000,000              | 2,000,000                |
| First American Capital Funding, Inc.  | Fountain Valley | CA           | 02-May-84            | SSBIC       | 823,250                | 1,646,000                |
| San Joaquin Business Invest. Group    | Fresno          | CA           | 23-Apr-88            | SSBIC       | 1,000,000              | 2,000,000                |
| Magna Pacific Investments             | Glendale        | CA           | 03-Dec-85            | SSBIC       | 1,080,000              | 2,160,000                |
| Asian American Capital Corporation    | Hayward         | CA           | 23-Feb-81            | SSBIC       | 706,200                | 0                        |
| South Bay Capital Corporation         | Long Beach      | CA           | 25-Oct-89            | SSBIC       | 1,020,000              | 0                        |
| Best Finance Corporation              | Los Angeles     | CA           | 24-Jun-87            | SSBIC       | 1,510,000              | 4,530,000                |
| Charterway Investment Corporation     | Los Angeles     | CA           | 04-Apr-84            | SSBIC       | 1,597,336              | 3,000,000                |
| Far East Capital Corp.                | Los Angeles     | CA           | 26-Jun-89            | SSBIC       | 1,025,000              | 1,500,000                |
| LaiLai Capital Corp.                  | Monterey Park   | CA           | 24-Nov-82            | SSBIC       | 1,500,000              | 3,425,000                |
| Allied Business Investors, Inc.       | Monterey Park   | CA           | 29-Dec-82            | SSBIC       | 600,000                | 1,200,000                |
| Draper Associates, a California LP    | Redwood City    | CA           | 12-Sep-79            | SBIC        | 2,015,000              | 6,000,000                |
| Bentley Capital                       | San Francisco   | CA           | 27-Aug-87            | SSBIC       | 1,500,000              | 5,960,000                |
| Positive Enterprises, Inc.            | San Francisco   | CA           | 06-Jun-80            | SSBIC       | 505,000                | 505,000                  |
| VK Capital Company                    | San Francisco   | CA           | 07-Feb-86            | SBIC        | 1,050,505              | 500,000                  |
| Western General Capital Corporation   | Sherman Oaks    | CA           | 02-Aug-89            | SSBIC       | 1,000,000              | 1,000,000                |
| Astar Capital Corp.                   | Temple City     | CA           | 06-Nov-86            | SSBIC       | 1,020,000              | 2,040,000                |
| <u>CONNECTICUT</u>                    |                 |              |                      |             |                        |                          |
| AB SBIC, Inc.                         | Cheshire        | CT           | 17-Nov-76            | SBIC        | 1,000,000              | 1,000,000                |
| Financial Opportunities, Inc.         | Enfield         | CT           | 17-Oct-74            | SBIC        | 1,900,000              | 4,238,638                |
| Marcon Capital Corp.                  | Southport       | CT           | 23-Oct-75            | SBIC        | 826,550                | 2,400,000                |
| Capital Resource Co. of Connecticut   | West Hartford   | CT           | 23-Mar-77            | SBIC        | 1,570,000              | 3,690,000                |
| <u>DISTRICT OF COLUMBIA</u>           |                 |              |                      |             |                        |                          |
| Multimedia Broadcast Invest. Corp.    | Washington      | DC           | 07-Aug-79            | SSBIC       | 1,353,559              | 1,000,000                |
| <u>FLORIDA</u>                        |                 |              |                      |             |                        |                          |
| BAC Investment Corp.                  | Miami           | FL           | 01-May-89            | SSBIC       | 1,144,000              | 0                        |
| Market Capital Corp.                  | Tampa           | FL           | 24-Mar-64            | SBIC        | 786,000                | 500,000                  |
| <u>GEORGIA</u>                        |                 |              |                      |             |                        |                          |
| Renaissance Capital Corporation       | Atlanta         | GA           | 05-Dec-86            | SSBIC       | 1,390,500              | 2,070,000                |
| First Growth Capital, Inc.            | Forsyth         | GA           | 16-Nov-89            | SSBIC       | 1,060,000              | 2,945,000                |
| <u>HAWAII</u>                         |                 |              |                      |             |                        |                          |
| Bancorp Hawaii SBIC                   | Honolulu        | HI           | 17-Feb-84            | SBIC        | 2,000,000              | 0                        |
| Pacific Venture Capital, Ltd.         | Honolulu        | HI           | 25-Jun-75            | SSBIC       | 1,500,000              | 500,000                  |

## SBIC Program Licensees with Private Capital of less than \$2.5 million by state as of 5/2/96

| <u>SBIC Name</u>                    | <u>City</u>     | <u>State</u> | <u>Date<br/>Licensed</u> | <u>Type</u> | <u>Private<br/>Capital</u> | <u>Leverage<br/>from SBA</u> |
|-------------------------------------|-----------------|--------------|--------------------------|-------------|----------------------------|------------------------------|
| <b>ILLINOIS</b>                     |                 |              |                          |             |                            |                              |
| Peterson Finance and Investment Co. | Chicago         | IL           | 07-Feb-84                | SSBIC       | 1,035,000                  | 0                            |
| Combined Fund, Inc. (The)           | Chicago         | IL           | 04-May-71                | SSBIC       | 1,100,250                  | 2,729,000                    |
| Shorebank Capital Corporation       | Chicago         | IL           | 03-Apr-78                | SSBIC       | 990,000                    | 1,450,000                    |
| <b>INDIANA</b>                      |                 |              |                          |             |                            |                              |
| Circle Ventures, Inc.               | Indianapolis    | IN           | 19-Aug-83                | SBIC        | 1,000,000                  | 500,000                      |
| <b>KENTUCKY</b>                     |                 |              |                          |             |                            |                              |
| Mountain Ventures, Inc.             | London          | KY           | 19-Dec-78                | SBIC        | 1,640,000                  | 0                            |
| <b>MASSACHUSETTS</b>                |                 |              |                          |             |                            |                              |
| UST Capital Corp.                   | Boston          | MA           | 06-Oct-61                | SBIC        | 1,752,800                  | 0                            |
| Northeast SBI Corp.                 | Boston          | MA           | 07-May-74                | SBIC        | 378,802                    | 1,130,000                    |
| Commonwealth Enterprise Fund Inc.   | Boston          | MA           | 28-May-92                | SSBIC       | 1,500,000                  | 0                            |
| Argonauts MESBIC Corporation        | Framingham      | MA           | 17-Jun-88                | SSBIC       | 1,140,237                  | 2,000,000                    |
| Business Achievement Corporation    | Newton          | MA           | 08-Aug-63                | SBIC        | 550,000                    | 1,490,000                    |
| <b>MARYLAND</b>                     |                 |              |                          |             |                            |                              |
| Secury Financial and Invest. Corp.  | Bethesda        | MD           | 29-Dec-83                | SSBIC       | 535,500                    | 1,500,000                    |
| <b>MICHIGAN</b>                     |                 |              |                          |             |                            |                              |
| White Pines Capital Corporation     | Ann Arbor       | MI           | 25-Feb-92                | SBIC        | 1,750,000                  | 0                            |
| Metro-Detroit Investment Co         | Farmington Hill | MI           | 01-Jun-78                | SSBIC       | 2,000,000                  | 6,000,000                    |
| <b>MISSOURI</b>                     |                 |              |                          |             |                            |                              |
| Bankers Capital Corp.               | Kansas City     | MO           | 12-Feb-76                | SBIC        | 632,000                    | 710,000                      |
| <b>MISSISSIPPI</b>                  |                 |              |                          |             |                            |                              |
| Sun-Delta Capital Access Center     | Greenville      | MS           | 25-Sep-79                | SSBIC       | 1,258,100                  | 0                            |
| <b>NEBRASKA</b>                     |                 |              |                          |             |                            |                              |
| United Financial Resources Corp.    | Omaha           | NE           | 07-Jul-83                | SBIC        | 750,000                    | 500,000                      |
| <b>NEW JERSEY</b>                   |                 |              |                          |             |                            |                              |
| Transpac Capital Corporation        | Clifton         | NJ           | 28-May-87                | SSBIC       | 1,000,000                  | 2,698,000                    |
| Capital Circulation Corporation     | Fort Lee        | NJ           | 28-Mar-85                | SSBIC       | 1,000,000                  | 2,000,000                    |
| Tappan Zee Capital Corporation      | Little Falls    | NJ           | 16-Nov-63                | SBIC        | 1,000,000                  | 2,700,000                    |
| Rutgers Minority Investment Co      | Newark          | NJ           | 28-Jul-70                | SSBIC       | 1,826,000                  | 0                            |
| ESLO Capital Corp.                  | Newark          | NJ           | 31-May-79                | SBIC        | 688,323                    | 1,030,000                    |
| <b>NEW YORK</b>                     |                 |              |                          |             |                            |                              |
| NYBDC Capital Corp.                 | Albany          | NY           | 02-Nov-73                | SBIC        | 500,000                    | 0                            |
| Vega Capital Corp.                  | Armonk          | NY           | 05-Aug-68                | SBIC        | 2,402,861                  | 4,280,000                    |
| Esquire Capital Corp.               | Commack         | NY           | 14-Feb-89                | SSBIC       | 1,266,200                  | 2,450,000                    |
| First County Capital Inc.           | Flushing        | NY           | 31-Mar-89                | SSBIC       | 1,325,000                  | 2,143,765                    |
| Flushing Capital Corporation        | Flushing        | NY           | 24-Dec-90                | SSBIC       | 1,000,000                  | 2,550,000                    |
| Situation Ventures Corporation      | Maspeth         | NY           | 16-Feb-77                | SSBIC       | 1,700,200                  | 1,000,000                    |
| Capital Investors & Management      | New York        | NY           | 06-Feb-80                | SSBIC       | 1,300,000                  | 1,950,000                    |
| Exim Capital Corp.                  | New York        | NY           | 05-Jan-79                | SSBIC       | 660,000                    | 1,310,000                    |
| Empire State Capital Corporation    | New York        | NY           | 05-Feb-91                | SSBIC       | 2,100,000                  | 6,300,000                    |
| East Coast Venture Capital, Inc.    | New York        | NY           | 14-Jul-86                | SSBIC       | 1,390,880                  | 2,700,000                    |
| Triad Capital Corp. of New York     | New York        | NY           | 25-Nov-83                | SSBIC       | 545,253                    | 500,000                      |
| Hanam Capital Corp.                 | New York        | NY           | 06-May-87                | SSBIC       | 1,402,000                  | 4,200,000                    |

## SBIC Program Licensees with Private Capital of less than \$2.5 million by state as of 5/2/96

| <u>SBIC Name</u>                     | <u>City</u>  | <u>State</u> | <u>Date<br/>Licensed</u> | <u>Type</u> | <u>Private<br/>Capital</u> | <u>Leverage<br/>from SBA</u> |
|--------------------------------------|--------------|--------------|--------------------------|-------------|----------------------------|------------------------------|
| American Asian Capital Corporation   | New York     | NY           | 12–Nov–76                | SSBIC       | 503,000                    | 500,000                      |
| United Capital Investment Corp.      | New York     | NY           | 05–Feb–85                | SSBIC       | 1,448,417                  | 2,300,000                    |
| Fair Capital Corp.                   | New York     | NY           | 27–Sep–82                | SSBIC       | 625,000                    | 500,000                      |
| Venture Opportunities Corporation    | New York     | NY           | 01–Dec–78                | SSBIC       | 2,141,522                  | 6,525,000                    |
| Trufty Capital Inc.                  | New York     | NY           | 01–May–89                | SSBIC       | 1,025,000                  | 2,025,000                    |
| Freshstart Venture Capital Corp.     | New York     | NY           | 24–Feb–83                | SSBIC       | 1,540,597                  | 5,790,000                    |
| Genesee Funding, Inc.                | Rochester    | NY           | 26–Nov–86                | SBIC        | 1,000,000                  | 600,000                      |
| Fundex Capital Corp.                 | Rye          | NY           | 18–May–78                | SBIC        | 2,258,659                  | 4,150,000                    |
| Winfield Capital Corp.               | White Plains | NY           | 19–Apr–72                | SBIC        | 1,250,000                  | 4,500,000                    |
| <u>OHIO</u>                          |              |              |                          |             |                            |                              |
| Enterprise Ohio Investment Co        | Dayton       | OH           | 29–Jul–81                | SSBIC       | 1,835,000                  | 500,000                      |
| Cactus Capital Company               | Worthington  | OH           | 22–Sep–89                | SSBIC       | 1,100,000                  | 1,100,000                    |
| <u>OREGON</u>                        |              |              |                          |             |                            |                              |
| Northern Pacific Capital Corporation | Portland     | OR           | 18–Jan–62                | SBIC        | 1,141,464                  | 1,000,000                    |
| <u>PENNSYLVANIA</u>                  |              |              |                          |             |                            |                              |
| Greater Philadelphia Venture Capital | Wayne        | PA           | 31–Mar–72                | SSBIC       | 760,981                    | 1,432,800                    |
| <u>PUERTO RICO</u>                   |              |              |                          |             |                            |                              |
| North America Investment Corp.       | Hato Rey     | PR           | 07–Nov–74                | SSBIC       | 1,287,500                  | 1,250,000                    |
| <u>RHODE ISLAND</u>                  |              |              |                          |             |                            |                              |
| Domestic Capital Corp.               | Cranston     | RI           | 11–Dec–84                | SBIC        | 500,000                    | 0                            |
| Moneta Capital Corp.                 | Providence   | RI           | 04–May–84                | SBIC        | 2,002,500                  | 6,000,000                    |
| Wallace Capital Corporation          | Providence   | RI           | 22–Dec–86                | SBIC        | 2,015,000                  | 2,750,000                    |
| <u>SOUTH CAROLINA</u>                |              |              |                          |             |                            |                              |
| Charleston Capital Corporation       | Charleston   | SC           | 21–Jun–61                | SBIC        | 1,487,424                  | 2,000,000                    |
| Reedy River Ventures Ltd Partners    | Greenville   | SC           | 16–Jul–81                | SBIC        | 1,524,627                  | 0                            |
| Floco Investment Company, Inc.       | Scranton     | SC           | 05–Jul–61                | SBIC        | 588,400                    | 0                            |
| <u>TENNESSEE</u>                     |              |              |                          |             |                            |                              |
| Valley Capital Corp.                 | Chattanooga  | TN           | 08–Oct–82                | SSBIC       | 1,145,000                  | 1,000,000                    |
| West Tennessee Venture Capital       | Memphis      | TN           | 16–Dec–82                | SSBIC       | 1,250,000                  | 0                            |
| International Paper Cap. Formation   | Memphis      | TN           | 05–Nov–81                | SSBIC       | 1,000,000                  | 1,000,000                    |
| <u>TEXAS</u>                         |              |              |                          |             |                            |                              |
| Tower Ventures, Inc.                 | Dallas       | TX           | 30–Jun–75                | SSBIC       | 1,764,616                  | 2,673,000                    |
| North Texas MESBIC, Inc.             | Dallas       | TX           | 11–Jul–91                | SSBIC       | 1,033,202                  | 3,100,000                    |
| HCT Capital Corp.                    | Fort Worth   | TX           | 01–Nov–91                | SBIC        | 2,125,000                  | 300,000                      |
| United Oriental Capital Corporation  | Houston      | TX           | 07–Jul–82                | SSBIC       | 1,700,000                  | 1,300,000                    |
| Chen's Financial Group, Inc.         | Houston      | TX           | 05–Mar–84                | SSBIC       | 1,500,000                  | 3,000,000                    |
| Charter Venture Group, Inc.          | Houston      | TX           | 10–Oct–80                | SBIC        | 1,685,000                  | 0                            |
| Jardine Capital Corp.                | Houston      | TX           | 22–Dec–86                | SSBIC       | 1,550,000                  | 2,000,000                    |
| MESBIC Financial Corp. of Houston    | Houston      | TX           | 12–Nov–76                | SSBIC       | 1,726,701                  | 1,679,000                    |
| SBI Capital Corp.                    | Houston      | TX           | 22–Oct–81                | SBIC        | 2,256,000                  | 250,000                      |
| <u>VIRGINIA</u>                      |              |              |                          |             |                            |                              |
| Continental SBIC                     | Arlington    | VA           | 19–Oct–90                | SSBIC       | 1,200,000                  | 0                            |
| East West United Investment Co.      | McLean       | VA           | 22–Jan–76                | SSBIC       | 500,000                    | 1,000,000                    |

SBIC Program Licensees with Private Capital of less than \$2.5 million by state as of 5/2/96

| <u>SBIC Name</u>                     | <u>City</u>    | <u>State</u> | <u>Date<br/>Licensed</u> | <u>Type</u> | <u>Private<br/>Capital</u> | <u>Leverage<br/>from SBA</u> |
|--------------------------------------|----------------|--------------|--------------------------|-------------|----------------------------|------------------------------|
| <u>VERMONT</u>                       |                |              |                          |             |                            |                              |
| Queneska Capital Corporation         | Burlington     | VT           | 25-Apr-88                | SBIC        | 1,500,000                  | 0                            |
| <u>WISCONSIN</u>                     |                |              |                          |             |                            |                              |
| Polaris Capital Corp.                | Brookfield     | WI           | 09-Feb-90                | SBIC        | 2,114,759                  | 2,460,000                    |
| <u>TOTAL Less than \$2.5 million</u> | <u>Number=</u> | <u>104</u>   |                          |             | <u>132,671,375</u>         | <u>189,475,203</u>           |

## SBIC Program Licensees as of 5/2/96 – SUMMARY

|  | <u>Number</u> |             | <u>Capital</u>         |             | <u>Leverage</u>        |             |
|--|---------------|-------------|------------------------|-------------|------------------------|-------------|
| <b>TOTAL</b>                               | <b>272</b>    | <b>100%</b> | <b>\$3,529,147,264</b> | <b>100%</b> | <b>\$1,113,041,396</b> | <b>100%</b> |
| Private capital greater than \$10 million  | 80            | 29%         | 2,972,273,958          | 84%         | 600,610,000            | 54%         |
| Private capital greater than \$5 million   | 123           | 45%         | 3,254,971,197          | 92%         | 830,321,192            | 75%         |
| Private capital greater than \$2.5 million | 168           | 62%         | 3,396,475,889          | 96%         | 923,566,193            | 83%         |
| Private capital greater than \$1.5 million | 207           | 76%         | 3,466,706,767          | 98%         | 1,021,826,831          | 92%         |
| Private capital less than \$2.5 million    | 104           | 38%         | 132,671,375            | 4%          | 189,475,203            | 17%         |
| Private capital less than \$1.5 million    | 65            | 24%         | 62,440,497             | 2%          | 91,214,565             | 8%          |

## SBIC Program Licensees as of 5/2/96

| <u>SBIC Name</u>                        | <u>City</u>   | <u>State</u> | <u>Date Licensed</u> | <u>Type</u> | <u>Private Capital</u> | <u>Leverage from SBA</u> |
|---|---------------|--------------|----------------------|-------------|------------------------|--------------------------|
| NationsBanc Capital Corporation         | Charlotte     | NC           | 26-Jun-61            | SBIC        | 212,214,193            | 0                        |
| Norwest Equity Partners IV              | Minneapolis   | MN           | 02-Aug-89            | SBIC        | 191,420,000            | 0                        |
| Chemical Venture Capital Assoc          | New York      | NY           | 22-Oct-84            | SBIC        | 168,914,772            | 0                        |
| Citicorp Venture Capital, Ltd.          | New York      | NY           | 18-Dec-67            | SBIC        | 127,197,602            | 0                        |
| BT Capital Partners, Inc.               | New York      | NY           | 10-Nov-72            | SBIC        | 119,998,033            | 0                        |
| Continental Illinois Venture Corp.      | Chicago       | IL           | 02-Apr-70            | SBIC        | 116,000,000            | 0                        |
| First Chicago Equity Corporation        | Chicago       | IL           | 08-Jun-61            | SBIC        | 103,100,000            | 0                        |
| Norwest Equity Partners V, L.P.         | Minneapolis   | MN           | 06-Feb-95            | SBIC        | 101,087,000            | 0                        |
| BankAmerica Ventures                    | Foster City   | CA           | 29-Jan-60            | SBIC        | 100,714,475            | 0                        |
| 399 Venture Partners                    | New York      | NY           | 02-Feb-89            | SBIC        | 100,000,000            | 0                        |
| BancBoston Ventures, Incorporated       | Boston        | MA           | 08-May-59            | SBIC        | 75,000,000             | 0                        |
| Sirrom Capital Corporation              | Nashville     | TN           | 14-May-92            | SBIC        | 69,925,095             | 83,260,000               |
| CIBC Wood Gundy Ventures, Inc.          | New York      | NY           | 26-Oct-90            | SBIC        | 55,477,000             | 0                        |
| Heller Equity Capital Corporation       | Chicago       | IL           | 19-Sep-80            | SBIC        | 53,379,346             | 0                        |
| J.P. Morgan Investment Corporation      | New York      | NY           | 10-Dec-87            | SBIC        | 50,294,000             | 0                        |
| Chase Manhattan Capital Corp            | New York      | NY           | 02-Aug-62            | SBIC        | 50,000,105             | 0                        |
| RFE Investment Partners V, L.P.         | New Canaan    | CT           | 19-Sep-94            | SBIC        | 49,537,500             | 28,700,000               |
| Key Equity Capital Corporation          | Cleveland     | OH           | 09-Dec-60            | SBIC        | 40,624,630             | 0                        |
| Fleet Venture Resources, Inc.           | Providence    | RI           | 18-Dec-67            | SBIC        | 35,007,068             | 0                        |
| Banc One Capital Partners Corp          | Dallas        | TX           | 08-Dec-76            | SBIC        | 34,942,000             | 0                        |
| Pyramid Ventures, Inc.                  | New York      | NY           | 26-Jun-87            | SBIC        | 33,000,000             | 0                        |
| Hall, Morns & Druva II, L.P.            | Mission Viejo | CA           | 05-Jul-78            | SBIC        | 32,117,778             | 0                        |
| CFB Venture Fund II, LP                 | St. Louis     | MO           | 02-Mar-93            | SBIC        | 30,606,000             | 0                        |
| Shaw Venture Partners III, L.P.         | Portland      | OR           | 26-Sep-94            | SBIC        | 30,075,188             | 0                        |
| Kline Hawkes California SBIC, L.P.      | Los Angeles   | CA           | 28-Jul-95            | SBIC        | 30,000,000             | 0                        |
| Mezzanine Capital Corporation           | Boston        | MA           | 28-May-87            | SBIC        | 30,000,000             | 0                        |
| Seacoast Capital Partners, L.P.         | Danvers       | MA           | 22-Aug-94            | SBIC        | 30,000,000             | 24,300,000               |
| Furman Selz SBIC, L.P.                  | New York      | NY           | 22-Aug-94            | SBIC        | 29,426,950             | 28,880,000               |
| SBIC Partners, L.P.                     | Fort Worth    | TX           | 22-Aug-94            | SBIC        | 29,375,515             | 33,400,000               |
| DFW Capital Partners, L.P.              | Teaneck       | NJ           | 19-Sep-94            | SBIC        | 28,963,936             | 21,290,000               |
| Cordova Capital Partners, L.P.          | Atlanta       | GA           | 24-Mar-94            | SBIC        | 27,500,000             | 5,000,000                |
| Stratford Capital Group, L.P.           | Dallas        | TX           | 19-May-94            | SBIC        | 25,700,000             | 5,000,000                |
| Fleet Equity Partners VI, L.P.          | Providence    | RI           | 11-Jan-95            | SBIC        | 25,297,162             | 0                        |
| Anthem Capital, L.P.                    | Baltimore     | MD           | 26-Sep-94            | SBIC        | 25,000,000             | 8,000,000                |
| Bando-McGlocklin SBIC                   | Brookfield    | WI           | 02-Sep-80            | SBIC        | 24,421,525             | 12,620,000               |
| First Commerce Capital, Inc.            | New Orleans   | LA           | 29-Jul-94            | SBIC        | 24,000,000             | 0                        |
| Hickory Venture Capital Corporation     | Huntsville    | AL           | 28-Mar-85            | SBIC        | 23,465,000             | 5,000,000                |
| Prospect Street NYC Discovery Fund      | New York      | NY           | 24-May-95            | SBIC        | 22,888,060             | 13,000,000               |
| Pacific Mezzanine Fund, L.P.            | Emeryville    | CA           | 24-Mar-94            | SBIC        | 22,501,912             | 11,840,000               |
| AVI Capital, L.P.                       | Los Altos     | CA           | 06-Feb-95            | SBIC        | 21,881,949             | 9,300,000                |
| PNC Capital Corp.                       | Wilmington    | DE           | 12-Aug-82            | SBIC        | 21,109,471             | 0                        |
| Pioneer Ventures Limited Partnership II | Boston        | MA           | 06-Feb-95            | SBIC        | 21,069,254             | 7,700,000                |
| Premier Venture Capital Corporation     | Baton Rouge   | LA           | 21-Feb-74            | SBIC        | 20,606,030             | 0                        |
| CB Investors, Inc.                      | New York      | NY           | 06-Nov-86            | SBIC        | 20,000,000             | 0                        |
| NatWest USA Capital Corporation         | New York      | NY           | 06-Feb-86            | SBIC        | 20,000,000             | 0                        |
| Ventex Partners, Ltd.                   | Houston       | TX           | 01-Nov-79            | SBIC        | 19,857,026             | 0                        |
| Eos Partners SBIC, L.P.                 | New York      | NY           | 19-Sep-94            | SBIC        | 19,653,500             | 16,900,000               |
| MidMark Capital, L.P.                   | Chatham       | NJ           | 26-Sep-94            | SBIC        | 17,446,265             | 11,960,000               |
| Meridian Venture Partners               | Radnor        | PA           | 24-Feb-87            | SBIC        | 16,919,869             | 13,360,000               |
| M & I Ventures Corp.                    | Milwaukee     | WI           | 19-Aug-85            | SBIC        | 16,048,370             | 0                        |
| Mercury Capital, L.P.                   | New York      | NY           | 26-Sep-94            | SBIC        | 15,576,893             | 7,500,000                |
| Exeter Equity Partners, L.P.            | New York      | NY           | 22-Dec-94            | SBIC        | 15,153,222             | 21,000,000               |
| LEG Partners SBIC, L.P.                 | New York      | NY           | 06-Apr-95            | SBIC        | 15,028,412             | 4,000,000                |
| Exeter Venture Lenders, L.P.            | New York      | NY           | 07-Feb-94            | SBIC        | 15,000,000             | 33,000,000               |



## SBIC Program Licensees as of 5/2/96

| <u>SBIC Name</u>                       | <u>City</u>    | <u>State</u> | <u>Date Licensed</u> | <u>Type</u> | <u>Private Capital</u> | <u>Leverage from SBA</u> |
|--|----------------|--------------|----------------------|-------------|------------------------|--------------------------|
| Canaan SBIC, L.P.                      | Rowayton       | CT           | 26-Sep-94            | SBIC        | 14,852,200             | 20,300,000               |
| Aspen Ventures West II, L.P.           | Los Altos      | CA           | 06-Nov-94            | SBIC        | 14,693,878             | 5,500,000                |
| Medallion Funding Corporation          | New York       | NY           | 23-Jun-80            | SSBIC       | 14,465,900             | 0                        |
| Capital Southwest Venture Corp.        | Dallas         | TX           | 13-Jul-61            | SBIC        | 14,229,271             | 11,000,000               |
| Allied Investment Corporation          | Washington     | DC           | 23-Apr-59            | SBIC        | 14,178,837             | 42,350,000               |
| Hanifen Imhoff Mezzanine Fund, L.P.    | Denver         | CO           | 26-Jul-94            | SBIC        | 14,135,000             | 22,210,000               |
| Union Venture Corp.                    | Los Angeles    | CA           | 30-Sep-67            | SBIC        | 13,445,324             | 0                        |
| Blue Ridge Investors Ltd.              | Greensboro     | NC           | 28-Jul-95            | SBIC        | 13,267,575             | 4,000,000                |
| First Union Capital Partners, Inc.     | Charlotte      | NC           | 15-Feb-90            | SBIC        | 13,180,025             | 0                        |
| U.S. Bancorp Capital Corporation       | Portland       | OR           | 05-Mar-81            | SBIC        | 13,026,892             | 0                        |
| Banc One Venture Corp.                 | Milwaukee      | WI           | 02-May-84            | SBIC        | 13,005,000             | 1,000,000                |
| River Cities Capital Fund L.P.         | Cincinnati     | OH           | 26-Sep-94            | SBIC        | 12,654,013             | 5,000,000                |
| CIP Capital L.P.                       | Malvern        | PA           | 03-Oct-91            | SBIC        | 12,208,278             | 9,000,000                |
| Zero Stage Capital V, L.P.             | Cambridge      | MA           | 26-Sep-94            | SBIC        | 12,194,444             | 8,400,000                |
| PMC Investment Corporation             | Dallas         | TX           | 26-Nov-86            | SSBIC       | 12,000,000             | 31,000,000               |
| Bay Partners SBIC, L.P.                | Cupertino      | CA           | 28-Jul-95            | SBIC        | 11,042,500             | 4,000,000                |
| CIT Group/Venture Capital, Inc.        | Livingston     | NJ           | 01-Jun-92            | SBIC        | 10,975,000             | 0                        |
| Geneva Middle Market Investors, L.P.   | Wellesley      | MA           | 27-Oct-95            | SBIC        | 10,920,010             | 5,000,000                |
| KCEP I, L.P.                           | Kansas City    | MO           | 19-Sep-94            | SBIC        | 10,791,879             | 11,100,000               |
| Pacific Northwest Partners SBIC, L.P.  | Bellevue       | WA           | 19-Sep-94            | SBIC        | 10,600,000             | 0                        |
| Sorrento Growth Partners I, L.P.       | San Diego      | CA           | 19-Sep-94            | SBIC        | 10,587,338             | 5,000,000                |
| TSG Ventures, Inc.                     | Stamford       | CT           | 07-May-71            | SSBIC       | 10,550,000             | 0                        |
| Pacific Capital, L.P.                  | Nashville      | TN           | 22-May-95            | SBIC        | 10,344,533             | 0                        |
| First Capital Group of Texas II, L.P.  | San Antonio    | TX           | 19-Apr-96            | SBIC        | 10,300,945             | 0                        |
| Walden-SBIC, L.P.                      | San Francisco  | CA           | 19-Sep-94            | SBIC        | 10,101,010             | 4,000,000                |
| KOCO Capital Company, L.P.             | Mount Kisco    | NY           | 25-Mar-94            | SBIC        | 10,000,000             | 8,740,000                |
| <b>TOTAL Greater than \$10 million</b> | <b>Number=</b> | <b>80</b>    |                      |             | <b>2,972,273,958</b>   | <b>600,610,000</b>       |
| Springdale Venture Partners, LP        | Charlotte      | NC           | 19-Jul-84            | SBIC        | 9,871,553              | 0                        |
| RFE Capital Partners, L.P.             | New Canaan     | CT           | 01-Jul-80            | SBIC        | 9,800,000              | 2,000,000                |
| Paribas Principal Incorporated         | New York       | NY           | 02-Aug-89            | SBIC        | 9,570,542              | 0                        |
| Kansas Venture Capital, Inc.           | Overland Park  | KS           | 17-Jun-77            | SBIC        | 9,549,116              | 0                        |
| Allied Capital Financial Corp.         | Washington     | DC           | 09-Aug-83            | SSBIC       | 9,350,000              | 25,950,000               |
| Blue Rock Capital, L.P.                | Wilmington     | DE           | 19-Apr-96            | SBIC        | 8,736,000              | 0                        |
| MorAmerica Capital Corporation         | Cedar Rapids   | IA           | 30-Sep-59            | SBIC        | 8,375,000              | 10,290,000               |
| Allied Investment Corporation II       | Washington     | DC           | 20-Mar-91            | SBIC        | 8,356,514              | 0                        |
| Imperial Ventures, Inc.                | Inglewood      | CA           | 31-Aug-78            | SBIC        | 8,001,731              | 0                        |
| Transportation Capital Corp.           | New York       | NY           | 23-Jun-80            | SSBIC       | 7,749,463              | 6,730,000                |
| Piper Jaffray Healthcare Capital L.P.  | Minneapolis    | MN           | 26-Sep-94            | SBIC        | 7,575,757              | 6,000,000                |
| Needham Capital SBIC, L.P.             | New York       | NY           | 19-Sep-94            | SBIC        | 7,500,000              | 4,710,000                |
| Elk Associates Funding Corporation     | New York       | NY           | 24-Jul-80            | SSBIC       | 7,479,940              | 8,831,000                |
| Walnut Capital Corp.                   | Chicago        | IL           | 07-Nov-83            | SBIC        | 7,321,800              | 8,000,000                |
| Gateway Partners, L.P.                 | St. Louis      | MO           | 24-Jan-95            | SBIC        | 7,284,462              | 3,700,000                |
| Edwards Capital Company                | New York       | NY           | 22-Jun-79            | SBIC        | 7,200,000              | 24,950,000               |
| Sundance Venture Partners, L.P.        | Cupertino      | CA           | 23-Apr-90            | SBIC        | 7,047,374              | 13,920,000               |
| Clarion Capital Corp.                  | Cleveland      | OH           | 25-Sep-68            | SBIC        | 6,970,219              | 10,260,000               |
| North Atlantic Venture Fund II, L.P.   | Portland       | ME           | 09-May-95            | SBIC        | 6,845,000              | 0                        |
| MFSBIC Ventures, Inc.                  | Dallas         | TX           | 26-Feb-70            | SSBIC       | 6,450,882              | 7,450,000                |
| Polestar Capital, Inc.                 | Chicago        | IL           | 22-Dec-70            | SSBIC       | 6,334,750              | 6,888,000                |
| Western Financial Capital Corp         | Dallas         | TX           | 22-Feb-80            | SBIC        | 6,046,744              | 19,540,000               |
| M & T Capital Corp.                    | Buffalo        | NY           | 29-Dec-67            | SBIC        | 6,007,486              | 0                        |
| CFB Venture Fund I, Inc.               | St. Louis      | MO           | 15-Oct-59            | SBIC        | 6,000,000              | 0                        |
| Capital Dimensions Ventures Fund       | Minneapolis    | MN           | 29-Jan-79            | SSBIC       | 5,635,741              | 7,402,192                |
| Dearborn Capital Corp.                 | Dearborn       | MI           | 14-Dec-78            | SSBIC       | 5,625,699              | 5,200,000                |

## SBIC Program Licensees as of 5/2/96

| <u>SBIC Name</u>                      | <u>City</u>       | <u>State</u> | <u>Date<br/>Licensed</u> | <u>Type</u> | <u>Private<br/>Capital</u> | <u>Leverage<br/>from SBA</u> |
|---------------------------------------|-------------------|--------------|--------------------------|-------------|----------------------------|------------------------------|
| Pioneer Ventures Limited              | Boston            | MA           | 20-Nov-86                | SBIC        | 5,609,745                  | 4,950,000                    |
| Opportunity Capital Partners II, L.P. | Fremont           | CA           | 07-May-93                | SSBIC       | 5,151,515                  | 0                            |
| First Fidelity Private Capital, Inc.  | Philadelphia      | PA           | 14-Jan-88                | SBIC        | 5,100,000                  | 0                            |
| North Dakota SBIC, L.P.               | Fargo             | ND           | 09-May-95                | SBIC        | 5,100,000                  | 0                            |
| Novus Ventures, L.P.                  | Cupertino         | CA           | 08-Nov-94                | SBIC        | 5,050,000                  | 4,400,000                    |
| Anker Capital Corporation             | Charleston        | WV           | 16-May-94                | SBIC        | 5,000,000                  | 0                            |
| Barclays Capital Investors Corp.      | New York          | NY           | 03-Oct-91                | SBIC        | 5,000,000                  | 0                            |
| Catalyst Fund, Ltd. (The)             | Houston           | TX           | 08-May-91                | SBIC        | 5,000,000                  | 1,970,000                    |
| First Security Business Investment    | Salt Lake City    | UT           | 18-Oct-93                | SBIC        | 5,000,000                  | 0                            |
| Greater Washington Investments        | Rockville         | MD           | 09-Feb-60                | SBIC        | 5,000,000                  | 14,500,000                   |
| IBJS Capital Corp.                    | New York          | NY           | 25-May-90                | SBIC        | 5,000,000                  | 0                            |
| Mapleleaf Capital Ltd.                | Dallas            | TX           | 06-Oct-80                | SBIC        | 5,000,000                  | 3,000,000                    |
| Norwood Venture Corp.                 | New York          | NY           | 18-Aug-80                | SBIC        | 5,000,000                  | 15,070,000                   |
| Société Générale Capital Corp.        | New York          | NY           | 19-Apr-96                | SBIC        | 5,000,000                  | 0                            |
| Sterling Commercial Capital, Inc.     | Great Neck        | NY           | 03-Oct-88                | SBIC        | 5,000,000                  | 12,000,000                   |
| Wells Fargo SBIC, Inc.                | San Francisco     | CA           | 12-Mar-96                | SBIC        | 5,000,000                  | 0                            |
| <u>WestVen Limited Partnership</u>    | <u>Charleston</u> | <u>WV</u>    | <u>01-Nov-93</u>         | <u>SBIC</u> | <u>5,000,000</u>           | <u>2,000,000</u>             |
| <u>TOTAL \$5 to \$10 million</u>      | <u>Number=</u>    | <u>43</u>    |                          |             | <u>282,697,239</u>         | <u>229,711,192</u>           |
| <u>TOTAL Greater than \$5 million</u> | <u>Number=</u>    | <u>123</u>   |                          |             | <u>3,254,971,197</u>       | <u>830,321,192</u>           |
| First New England Capital, LP         | Hartford          | CT           | 25-Mar-88                | SBIC        | 4,968,553                  | 6,500,000                    |
| National City Capital Corporation     | Cleveland         | OH           | 08-Feb-79                | SBIC        | 4,924,000                  | 0                            |
| Capital Investments, Inc.             | Mequon            | WI           | 25-May-59                | SBIC        | 4,783,245                  | 10,730,000                   |
| Wasatch Venture Corporation           | Salt Lake City    | UT           | 15-Apr-94                | SBIC        | 4,500,000                  | 3,500,000                    |
| Equitas, L.P.                         | Nashville         | TN           | 05-Nov-93                | SBIC        | 4,484,848                  | 6,900,000                    |
| Chestnut Street Partners, Inc.        | Boston            | MA           | 03-Dec-86                | SBIC        | 4,000,000                  | 0                            |
| CMNY Capital II, L.P.                 | New York          | NY           | 30-Jun-89                | SBIC        | 4,000,000                  | 4,500,000                    |
| Marwit Capital Corp.                  | Newport Beach     | CA           | 03-May-62                | SBIC        | 3,977,954                  | 5,260,000                    |
| Equal Opportunity Finance, Inc.       | Louisville        | KY           | 24-Sep-70                | SSBIC       | 3,890,735                  | 1,600,000                    |
| Ibero American Investors Corp.        | Rochester         | NY           | 28-Sep-79                | SSBIC       | 3,754,283                  | 3,903,301                    |
| Alliance Business Investment Co       | Tulsa             | OK           | 12-Aug-59                | SBIC        | 3,480,502                  | 0                            |
| Broadcast Capital, Inc.               | Washington        | DC           | 26-Nov-80                | SSBIC       | 3,350,000                  | 4,800,000                    |
| Syncom Capital Corp.                  | Silver Spring     | MD           | 10-Jul-78                | SSBIC       | 3,350,000                  | 0                            |
| Jupiter Partners                      | San Francisco     | CA           | 26-Oct-62                | SBIC        | 3,253,720                  | 2,260,000                    |
| InterEquity Capital Partners, LP      | New York          | NY           | 17-Dec-90                | SBIC        | 3,151,959                  | 6,430,000                    |
| FJC Growth Capital Corporation        | Huntsville        | AL           | 07-Mar-91                | SSBIC       | 3,142,401                  | 2,500,000                    |
| First Wall Street SBIC, LP            | New York          | NY           | 01-Feb-89                | SBIC        | 3,050,000                  | 9,000,000                    |
| Cambridge Ventures, LP                | Indianapolis      | IN           | 06-Jul-92                | SBIC        | 3,046,150                  | 1,000,000                    |
| Atlanta Investment Company, Inc.      | Incline Village   | NV           | 22-Jun-79                | SBIC        | 3,045,288                  | 0                            |
| Alliance Enterprise Corporation       | Dallas            | TX           | 20-Oct-71                | SSBIC       | 3,030,200                  | 4,480,000                    |
| Pierre Funding Corp.                  | New York          | NY           | 22-Jan-81                | SSBIC       | 3,013,473                  | 3,541,200                    |
| Argentum Capital Partners, LP         | New York          | NY           | 31-Jan-90                | SBIC        | 3,000,000                  | 5,360,000                    |
| Motor Enterprises, Inc.               | Warren            | MI           | 13-Apr-70                | SSBIC       | 3,000,000                  | 0                            |
| UNCO Ventures, Ltd.                   | Houston           | TX           | 30-Sep-88                | SBIC        | 3,000,000                  | 3,000,000                    |
| Victoria Capital Corp.                | Victoria          | TX           | 08-May-61                | SBIC        | 3,000,000                  | 0                            |
| Milestone Growth Fund, Inc.           | Minneapolis       | MN           | 27-Dec-89                | SSBIC       | 2,979,403                  | 2,000,000                    |
| Future Value Ventures, Incorporated   | Milwaukee         | WI           | 09-Nov-84                | SSBIC       | 2,882,307                  | 0                            |
| Green Mountain Capital, L.P.          | Waterbury         | VT           | 29-Mar-93                | SBIC        | 2,842,391                  | 1,000,000                    |
| AMT Capital, Ltd.                     | Dallas            | TX           | 07-Oct-91                | SBIC        | 2,548,908                  | 0                            |
| Opportunity Capital Corporation       | Fremont           | CA           | 23-Sep-71                | SSBIC       | 2,526,043                  | 2,180,500                    |
| Houston Partners, SBIP                | Houston           | TX           | 19-Nov-85                | SBIC        | 2,521,587                  | 2,800,000                    |
| First Interstate Equity Corp.         | Phoenix           | AZ           | 01-Feb-89                | SBIC        | 2,506,742                  | 0                            |
| 1st Source Capital Corporation        | South Bend        | IN           | 23-Dec-83                | SBIC        | 2,500,000                  | 0                            |
| ABN AMRO Capital (USA) Inc.           | Chicago           | IL           | 31-Jan-96                | SBIC        | 2,500,000                  | 0                            |

## SBIC Program Licensees as of 5/2/96

| SBIC Name                               | City            | State      | Date Licensed | Type  | Private Capital      | Leverage from SBA  |
|---|-----------------|------------|---------------|-------|----------------------|--------------------|
| BancFirst Investment Corporation        | Oklahoma City   | OK         | 01-Apr-94     | SBIC  | 2,500,000            | 0                  |
| Capital Fund, Inc.                      | Lansing         | MI         | 08-Sep-93     | SBIC  | 2,500,000            | 0                  |
| CoreStates Enterprise Capital, Inc.     | Philadelphia    | PA         | 19-Apr-96     | SBIC  | 2,500,000            | 0                  |
| Creditanstalt SBIC                      | New York        | NY         | 25-Aug-95     | SBIC  | 2,500,000            | 0                  |
| Mellon Ventures, L.P.                   | Pittsburg       | PA         | 12-Mar-96     | SBIC  | 2,500,000            | 0                  |
| NationsBanc SBIC Corporation            | Charlotte       | NC         | 19-Jul-84     | SBIC  | 2,500,000            | 0                  |
| Shenandoah Venture Capital L.P.         | Charleston      | WV         | 01-Jun-95     | SBIC  | 2,500,000            | 0                  |
| Sixty Wall Street SBIC Fund, L.P.       | New York        | NY         | 25-Aug-95     | SBIC  | 2,500,000            | 0                  |
| TLC Funding Corp.                       | Tarrytown       | NY         | 29-Feb-80     | SBIC  | 2,500,000            | 0                  |
| UBS Partners, Inc.                      | New York        | NY         | 24-May-95     | SBIC  | 2,500,000            | 0                  |
| United Missouri Capital Corporation     | Kansas City     | MO         | 21-Sep-84     | SBIC  | 2,500,000            | 0                  |
| <b>TOTAL \$2.5 to \$5 million</b>       | <b>Number=</b>  | <b>45</b>  |               |       | <b>141,504,692</b>   | <b>93,245,001</b>  |
| <b>TOTAL Greater than \$2.5 million</b> | <b>Number=</b>  | <b>168</b> |               |       | <b>3,396,475,889</b> | <b>923,568,193</b> |
| Vega Capital Corp.                      | Armonk          | NY         | 05-Aug-68     | SBIC  | 2,402,861            | 4,280,000          |
| Fundex Capital Corp.                    | Rye             | NY         | 18-May-78     | SBIC  | 2,258,659            | 4,150,000          |
| SBI Capital Corp.                       | Houston         | TX         | 22-Oct-81     | SBIC  | 2,256,000            | 250,000            |
| First SBIC of Alabama                   | Mobile          | AL         | 20-Jul-78     | SBIC  | 2,166,700            | 5,950,000          |
| Venture Opportunities Corporation       | New York        | NY         | 01-Dec-78     | SSBIC | 2,141,522            | 6,525,000          |
| HCT Capital Corp.                       | Fort Worth      | TX         | 01-Nov-91     | SBIC  | 2,125,000            | 300,000            |
| Polans Capital Corp.                    | Brookfield      | WI         | 09-Feb-90     | SBIC  | 2,114,753            | 2,460,000          |
| Empire State Capital Corporation        | New York        | NY         | 05-Feb-91     | SSBIC | 2,100,000            | 6,300,000          |
| Draper Associates, a California LP      | Redwood City    | CA         | 12-Sep-79     | SBIC  | 2,015,000            | 6,000,000          |
| Wallace Capital Corporation             | Providence      | RI         | 22-Dec-86     | SBIC  | 2,015,000            | 2,750,000          |
| Moneta Capital Corp.                    | Providence      | RI         | 04-May-84     | SBIC  | 2,002,500            | 6,000,000          |
| Bancorp Hawaii SBIC                     | Honolulu        | HI         | 17-Feb-84     | SBIC  | 2,000,000            | 0                  |
| Fulcrum Venture Capital Corp            | Culver City     | CA         | 05-Jul-78     | SSBIC | 2,000,000            | 2,000,000          |
| Metro-Detroit Investment Co             | Farmington Hill | MI         | 01-Jun-78     | SSBIC | 2,000,000            | 6,000,000          |
| Financial Opportunities, Inc.           | Enfield         | CT         | 17-Oct-74     | SBIC  | 1,900,000            | 4,238,638          |
| Enterprise Ohio Investment Co           | Dayton          | OH         | 29-Jul-81     | SSBIC | 1,835,000            | 500,000            |
| Rutgers Minority Investment Co          | Newark          | NJ         | 28-Jul-70     | SSBIC | 1,826,000            | 0                  |
| Tower Ventures, Inc.                    | Dallas          | TX         | 30-Jun-75     | SSBIC | 1,764,616            | 2,673,000          |
| UST Capital Corp.                       | Boston          | MA         | 06-Oct-61     | SBIC  | 1,752,800            | 0                  |
| White Pines Capital Corporation         | Ann Arbor       | MI         | 25-Feb-92     | SBIC  | 1,750,000            | 0                  |
| MESBIC Financial Corp. of Houston       | Houston         | TX         | 12-Nov-76     | SSBIC | 1,726,701            | 1,679,000          |
| Situation Ventures Corporation          | Maspeth         | NY         | 16-Feb-77     | SSBIC | 1,700,200            | 1,000,000          |
| United Oriental Capital Corporation     | Houston         | TX         | 07-Jul-82     | SSBIC | 1,700,000            | 1,300,000          |
| Charter Venture Group, Inc.             | Houston         | TX         | 10-Oct-80     | SBIC  | 1,685,000            | 0                  |
| Mountain Ventures, Inc.                 | London          | KY         | 19-Dec-78     | SBIC  | 1,640,000            | 0                  |
| Charterway Investment Corporation       | Los Angeles     | CA         | 04-Apr-84     | SSBIC | 1,597,336            | 3,000,000          |
| Capital Resource Co. of Connecticut     | West Hartford   | CT         | 23-Mar-77     | SBIC  | 1,570,000            | 3,690,000          |
| Alabama Capital Corporation             | Mobile          | AL         | 28-Jul-81     | SSBIC | 1,550,000            | 500,000            |
| Jardine Capital Corp.                   | Houston         | TX         | 22-Dec-86     | SSBIC | 1,550,000            | 2,000,000          |
| Freshstart Venture Capital Corp.        | New York        | NY         | 24-Feb-83     | SSBIC | 1,540,597            | 5,790,000          |
| Reedy River Ventures Ltd Partners       | Greenville      | SC         | 16-Jul-81     | SBIC  | 1,524,627            | 0                  |
| Best Finance Corporation                | Los Angeles     | CA         | 24-Jun-87     | SSBIC | 1,510,000            | 4,530,000          |
| Calsafe Capital Corp.                   | Alhambra        | CA         | 28-Dec-88     | SSBIC | 1,510,000            | 1,510,000          |
| Bentley Capital                         | San Francisco   | CA         | 27-Aug-87     | SSBIC | 1,500,000            | 5,960,000          |
| Chen's Financial Group, Inc.            | Houston         | TX         | 05-Mar-84     | SSBIC | 1,500,000            | 3,000,000          |
| Commonwealth Enterprise Fund Inc.       | Boston          | MA         | 28-May-92     | SSBIC | 1,500,000            | 0                  |
| LaiLai Capital Corp.                    | Monterey Park   | CA         | 24-Nov-82     | SSBIC | 1,500,000            | 3,425,000          |
| Pacific Venture Capital, Ltd.           | Honolulu        | HI         | 25-Jun-75     | SSBIC | 1,500,000            | 500,000            |
| Queneska Capital Corporation            | Burlington      | VT         | 25-Apr-88     | SBIC  | 1,500,000            | 0                  |
| Charleston Capital Corporation          | Charleston      | SC         | 21-Jun-61     | SBIC  | 1,487,424            | 2,000,000          |

## SBIC Program Licensees as of 5/2/96

| <u>SBIC Name</u>                      | <u>City</u>     | <u>State</u> | <u>Date Licensed</u> | <u>Type</u> | <u>Private Capital</u> | <u>Leverage from SBA</u> |
|---------------------------------------|-----------------|--------------|----------------------|-------------|------------------------|--------------------------|
| United Capital Investment Corp.       | New York        | NY           | 05-Feb-85            | SSBIC       | 1,448,417              | 2,300,000                |
| Hanam Capital Corp.                   | New York        | NY           | 06-May-87            | SSBIC       | 1,402,000              | 4,200,000                |
| East Coast Venture Capital, Inc.      | New York        | NY           | 14-Jul-86            | SSBIC       | 1,390,880              | 2,700,000                |
| Renaissance Capital Corporation       | Atlanta         | GA           | 05-Dec-86            | SSBIC       | 1,390,500              | 2,070,000                |
| Multimedia Broadcast Invest. Corp.    | Washington      | DC           | 07-Aug-79            | SSBIC       | 1,353,559              | 1,000,000                |
| First County Capital Inc.             | Flushing        | NY           | 31-Mar-89            | SSBIC       | 1,325,000              | 2,143,765                |
| Capital Investors & Management        | New York        | NY           | 06-Feb-80            | SSBIC       | 1,300,000              | 1,950,000                |
| North America Investment Corp.        | Hato Rey        | PR           | 07-Nov-74            | SSBIC       | 1,287,500              | 1,250,000                |
| Esquire Capital Corp.                 | Commack         | NY           | 14-Feb-89            | SSBIC       | 1,266,200              | 2,450,000                |
| Sun-Delta Capital Access Center       | Greenville      | MS           | 25-Sep-79            | SSBIC       | 1,258,100              | 0                        |
| West Tennessee Venture Capital        | Memphis         | TN           | 16-Dec-82            | SSBIC       | 1,250,000              | 0                        |
| Winfield Capital Corp.                | White Plains    | NY           | 19-Apr-72            | SBIC        | 1,250,000              | 4,500,000                |
| Continental SBIC                      | Arlington       | VA           | 19-Oct-90            | SSBIC       | 1,200,000              | 0                        |
| Small Business Investment Capital     | Little Rock     | AR           | 06-Mar-75            | SBIC        | 1,150,000              | 3,250,000                |
| Valley Capital Corp.                  | Chattanooga     | TN           | 08-Oct-82            | SSBIC       | 1,145,000              | 1,000,000                |
| BAC Investment Corp.                  | Miami           | FL           | 01-May-89            | SSBIC       | 1,144,000              | 0                        |
| Northern Pacific Capital Corporation  | Portland        | OR           | 18-Jan-62            | SBIC        | 1,141,464              | 1,000,000                |
| Argonauts MESBIC Corporation          | Framingham      | MA           | 17-Jun-88            | SSBIC       | 1,140,237              | 2,000,000                |
| Combined Fund, Inc. (The)             | Chicago         | IL           | 04-May-71            | SSBIC       | 1,100,250              | 2,729,000                |
| Cactus Capital Company                | Worthington     | OH           | 22-Sep-89            | SSBIC       | 1,100,000              | 1,100,000                |
| Magna Pacific Investments             | Glendale        | CA           | 03-Dec-85            | SSBIC       | 1,080,000              | 2,160,000                |
| First Growth Capital, Inc.            | Forsyth         | GA           | 16-Nov-89            | SSBIC       | 1,060,000              | 2,945,000                |
| VK Capital Company                    | San Francisco   | CA           | 07-Feb-86            | SBIC        | 1,050,505              | 500,000                  |
| Peterson Finance and Investment Co.   | Chicago         | IL           | 07-Feb-84            | SSBIC       | 1,035,000              | 0                        |
| North Texas MESBIC, Inc.              | Dallas          | TX           | 11-Jul-91            | SSBIC       | 1,033,202              | 3,100,000                |
| Far East Capital Corp.                | Los Angeles     | CA           | 26-Jun-89            | SSBIC       | 1,025,000              | 1,500,000                |
| Trusty Capital Inc.                   | New York        | NY           | 01-May-89            | SSBIC       | 1,025,000              | 2,025,000                |
| Astar Capital Corp.                   | Temple City     | CA           | 06-Nov-86            | SSBIC       | 1,020,000              | 2,040,000                |
| South Bay Capital Corporation         | Long Beach      | CA           | 25-Oct-89            | SSBIC       | 1,020,000              | 0                        |
| First Commerce & Loan LP              | Tucson          | AZ           | 19-Oct-90            | SBIC        | 1,012,000              | 1,000,000                |
| Alabama Small Business Investment Co. | Birmingham      | AL           | 05-Apr-88            | SSBIC       | 1,005,000              | 2,000,000                |
| AB SBIC, Inc.                         | Cheshire        | CT           | 17-Nov-76            | SBIC        | 1,000,000              | 1,000,000                |
| Capital Circulation Corporation       | Fort Lee        | NJ           | 28-Mar-85            | SSBIC       | 1,000,000              | 2,000,000                |
| Circle Ventures, Inc.                 | Indianapolis    | IN           | 19-Aug-83            | SBIC        | 1,000,000              | 500,000                  |
| Flushing Capital Corporation          | Flushing        | NY           | 24-Dec-90            | SSBIC       | 1,000,000              | 2,550,000                |
| Genesee Funding, Inc.                 | Rochester       | NY           | 26-Nov-86            | SBIC        | 1,000,000              | 600,000                  |
| International Paper Cap. Formation    | Memphis         | TN           | 05-Nov-81            | SSBIC       | 1,000,000              | 1,000,000                |
| San Joaquin Business Invest. Group    | Fresno          | CA           | 23-Apr-88            | SSBIC       | 1,000,000              | 2,000,000                |
| Tappan Zee Capital Corporation        | Little Falls    | NJ           | 16-Nov-63            | SBIC        | 1,000,000              | 2,700,000                |
| Transpac Capital Corporation          | Clifton         | NJ           | 28-May-87            | SSBIC       | 1,000,000              | 2,698,000                |
| Western General Capital Corporation   | Sherman Oaks    | CA           | 02-Aug-89            | SSBIC       | 1,000,000              | 1,000,000                |
| Shorebank Capital Corporation         | Chicago         | IL           | 03-Apr-78            | SSBIC       | 980,000                | 1,450,000                |
| Marcon Capital Corp.                  | Southport       | CT           | 23-Oct-75            | SBIC        | 826,550                | 2,400,000                |
| First American Capital Funding, Inc.  | Fountain Valley | CA           | 02-May-84            | SSBIC       | 823,250                | 1,646,000                |
| Market Capital Corp.                  | Tampa           | FL           | 24-Mar-64            | SBIC        | 786,000                | 500,000                  |
| Greater Philadelphia Venture Capital  | Wayne           | PA           | 31-Mar-72            | SSBIC       | 760,981                | 1,432,800                |
| United Financial Resources Corp.      | Omaha           | NE           | 07-Jul-83            | SBIC        | 750,000                | 500,000                  |
| Asian American Capital Corporation    | Hayward         | CA           | 23-Feb-81            | SSBIC       | 706,200                | 0                        |
| ESLO Capital Corp.                    | Newark          | NJ           | 31-May-79            | SBIC        | 688,323                | 1,030,000                |
| Exim Capital Corp.                    | New York        | NY           | 05-Jan-79            | SSBIC       | 660,000                | 1,310,000                |
| Bankers Capital Corp.                 | Kansas City     | MO           | 12-Feb-76            | SBIC        | 632,000                | 710,000                  |
| Fair Capital Corp.                    | New York        | NY           | 27-Sep-82            | SSBIC       | 625,000                | 500,000                  |
| Allied Business Investors, Inc.       | Monterey Park   | CA           | 29-Dec-82            | SSBIC       | 600,000                | 1,200,000                |
| Ally Finance Corp.                    | Beverly Hills   | CA           | 04-Jun-82            | SSBIC       | 600,000                | 950,000                  |

## SBIC Program Licensees as of 5/2/96

| <u>SBIC Name</u>                        | <u>City</u>    | <u>State</u> | <u>Date<br/>Licensed</u> | <u>Type</u> | <u>Private<br/>Capital</u> | <u>Leverage<br/>from SBA</u> |
|---|----------------|--------------|--------------------------|-------------|----------------------------|------------------------------|
| Floco Investment Company, Inc.          | Scranton       | SC           | 05-Jul-61                | SBIC        | 588,400                    | 0                            |
| Business Achievement Corporation        | Newton         | MA           | 08-Aug-63                | SBIC        | 550,000                    | 1,490,000                    |
| Triad Capital Corp. of New York         | New York       | NY           | 25-Nov-83                | SSBIC       | 545,253                    | 500,000                      |
| Security Financial and Invest. Corp.    | Bethesda       | MD           | 29-Dec-83                | SSBIC       | 535,500                    | 1,500,000                    |
| Positive Enterprises, Inc.              | San Francisco  | CA           | 06-Jun-80                | SSBIC       | 505,000                    | 505,000                      |
| American Asian Capital Corporation      | New York       | NY           | 12-Nov-76                | SSBIC       | 503,000                    | 500,000                      |
| Domestic Capital Corp.                  | Cranston       | RI           | 11-Dec-84                | SBIC        | 500,000                    | 0                            |
| East West United Investment Co.         | McLean         | VA           | 22-Jan-76                | SSBIC       | 500,000                    | 1,000,000                    |
| NYBDC Capital Corp.                     | Albany         | NY           | 02-Nov-73                | SBIC        | 500,000                    | 0                            |
| Northeast SBI Corp.                     | Boston         | MA           | 07-May-74                | SBIC        | 378,802                    | 1,130,000                    |
| <u>TOTAL Less than \$2.5 million</u>    | <u>Number=</u> | <u>104</u>   |                          |             | <u>132,671,375</u>         | <u>189,475,203</u>           |
| <u>TOTAL Greater than \$2.5 million</u> | <u>Number=</u> | <u>168</u>   |                          |             | <u>3,396,475,889</u>       | <u>923,566,193</u>           |
| <u>TOTAL ALL LICENSEES</u>              | <u>Number=</u> | <u>272</u>   |                          |             | <u>3,529,147,264</u>       | <u>1,113,041,398</u>         |

Chairman BOND. Thank you very much, Ms. Forbes.

Before going on with our panel, we have been joined by our distinguished ranking member who has had all kinds of praises already heaped upon him for his work in 1992 on this particular area. Senator Bumpers, do you have a statement?

Senator BUMPERS. Mr. Chairman, I have an opening statement, which I will be happy to submit for the record.

[The prepared statement of Senator Bumpers follows:]

PREPARED STATEMENT OF SENATOR DALE BUMPERS  
U.S. SENATE COMMITTEE ON SMALL BUSINESS  
MAY 10, 1996

Mr. Chairman, thank you for holding this hearing on your proposed legislation to improve the Small Business Investment Company program. The draft bill you have circulated is a continuation of this Committee's efforts stretching back to 1990 to make the SBIC program more efficient, thereby reducing risks and costs to the taxpayer. As you are well aware, we held seven hearings in the 101st and 102nd Congresses to deal with a number of problems in the SBIC program, including several cases of fraud and abuse.

Based on those hearings, some of which were extremely difficult and complex, we passed the Small Business Credit and Business Opportunity Enhancement Act of 1992, P.L. 102-366, which President Bush signed into law that year. This act instituted several important changes to the SBIC program. Among these were the development of government-held Participating Securities as a method of financing for SBICs, as well as a number of safeguards to protect against fraud and abuse. Although it took an inordinate amount of time, the SBA acted on the new law's requirements and instituted new regulations which have been very effective in improving the program's operations. Perhaps it is something of a tribute to the agency that your bill would codify many of the regulatory changes made since 1993. However, I am concerned that we should not attempt to congressionally micromanage this unique program or impose undue regulatory burdens on either the SBIC or SBA. It seems to me that we should carefully assess the effect of recent changes in statute and regulation before laying on an extra layer.

But primarily we are faced with the problem of how to continue adequate funding for the SBIC program during an era of government downsizing. The consensus view is that this program holds great possibilities for the American economy and should be expanded significantly. The Administration has offered one proposal for financing the SBIC program, and your bill sets out a variation of that, both based on fee increases to be paid by the SBIC industry. There is little doubt that fees must go up, given that appropriations are likely to shrink. The key question is, "How great must the fee increase be, and how must it be structured, in order to provide this segment of the venture capital industry with adequate leverage at a fair cost?"

With that in mind, I look forward to hearing from our witnesses and hope they can offer valuable suggestions in this regard. Mr. Chairman, again, thank you for holding this hearing. Our witnesses have my full attention.



Chairman BOND. We will be happy to have that statement. Thank you very much.

Now let me turn to Mr. Terry Jones.

**STATEMENT OF TERRY L. JONES, PRESIDENT, SYNCOM  
CAPITAL CORPORATION, SILVER SPRING, MARYLAND**

Mr. JONES. Thank you, Senator. We have submitted a statement which I am sure will be in the record.

Chairman BOND. It will be made a part of the record. Thank you for submitting it.

Mr. JONES. I, too, will try to be brief. Mr. Chairman and members of the Committee, my name is Terry Jones. I am president of SYNCOM Capital Corporation, which is an SSBIC which focuses on investments in the telecommunications industry throughout America.

SYNCOM Capital received its license in 1978 and began with only \$1.25 million in private capital. Since our inception 18 years ago, SYNCOM has invested approximately \$18 million through this program in about 52 transactions and those transactions have leveraged approximately \$375 million as I added it up earlier this week, from that small capital base.

SYNCOM is but one of four investment companies that my partners and I now manage. We were able, because of this program and because of our success growth, to receive additional funds from institutional investors. In fact \$55 million we have raised in the last few years from institutional investors, mostly public and private pension funds including such names as California State Teachers Retirement System, Ameritech, Teachers Insurance and Annuity, State of Connecticut, and on and on. We today manage approximately \$100 million from that beginning in 1978.

I am also chairman of the National Association of Investment Companies, which you mentioned earlier is the trade association for the SSBIC segment of this industry. The preponderance of NAIC members are SSBICs, even though they do include private equity funds and other non-SBICs, who finance small businesses in nearly all of the States represented by the members of this Committee.

I would like to jump ahead a little bit and focus your attention on, if you have it there in my testimony, exhibits one through six initially, which illustrate the types of investments that have been made by the SSBIC segment of this industry from 1981 to 1991. This is dated by 5 years but I think it is illustrative of the range of ethnic groups and entrepreneurs funded by the SSBIC segment of this industry quite successfully.

You will see that the total investment during that period has been approximately \$113 million with the average investment size just under \$200,000 and the number of investments during that period ending 5 years ago was just under 700, at 653 investments.

The other exhibits there, two, three, four, and five, detail that a little more explicitly, showing investments by State, investments by industry, et cetera, for the record.

Looking at exhibit seven, I put together here some examples, some narrative rather of some of the venture investments that have been made, including Alamo Technologies in Texas; a com-

pany here in Washington, D.C., a woman-owned radio company that now has three stations in Washington, four in Baltimore, two in Atlanta, approximately \$150 million in value which we funded with two other SSBICs with investments of less than \$300,000 per SBIC. It has grown to that. And other funds.

It is interesting to note, also, that some of these are now public companies, Envirotech and I think Micronics, et cetera. So we believe we are as good as anybody and have done better than most in the venture capital business, even though we do serve "the small side of the industry."

Finally, Mr. Chairman, the last exhibit that I bring to your attention is exhibit eight which shows by State a chart showing the SSBICs and the SBIC licensees of under \$2.5 million, which are located in each member's State of this Committee, Alabama, Arkansas, Connecticut, et cetera. These are the companies that, of course, would be directly affected by this proposal for elimination of these funds.

I want to jump ahead again and focus back on the testimony on page 5, where I raise two points which I really think are germane to the discussion here. These points, I think, are questions that the Committee must answer in order to arrive at a policy and a piece of legislation which is appropriate.

First and foremost is the question is there still the need for a Government-sponsored small business venture capital program anyway? Is there compelling public policy interest which can be addressed through this program?

Second, if the answer happens to be yes, then who should be served? What is meant by the phrase small business as we are now using it? And given that the median venture capital fund closed in 1994, the non-SBIC venture capital fund that closed in 1994 was \$50 million, and therefore that market is being served, does this bill target itself toward creation of funds that will compete directly with the private venture capital fund and leave the underserved market that perhaps it was intended to create, or not?

Clearly, the answers to these questions will determine, to a large degree, who will receive licenses in the future and who will not, and also who will receive leverage and what kind of leverage that will be.

Eighty percent of the SSBICs are, in fact—have private capital below \$2.5 million and there is a lot of discussion about the term private capital, as if it is some sort of magic indication of success. The reality is, if you are in this business, you understand that total assets under management is, in fact, a criteria for the ability to generate income to be viable, rather than private capital.

There are funds of less than \$2.5 million or at \$2.5 million with one or two tiers of leverage which, in fact, have therefore \$7 million or \$8 million in assets on which they earn income. Are they non-viable versus a fund of \$5 million with no leverage? I think the answer is that that is not necessarily shown to be true.

In 1991 the SBA sponsored an advisory council which, among other recommendations, created a participating security. Prior to that point, I believe—and I will stand to be corrected—most of the SBICs in this industry were less than \$10 million in private cap-

ital. Is that true? And probably a good number, if not most, or perhaps the median was at \$5 million or below.

The problem they had was that their investments did not match their liabilities. In other words, they had, in receiving debt, which SBICs were only limited to receive, they were not able to make equity investments and pay that debt on a timely basis. And so this participating security was created as patient capital.

It is ironic to us that this new security, which was developed to address that debenture debt burden of the existing SBICs, is now being proposed to be restricted to funds of more than \$10 million. In other words, the guys who were supposed to be assisted by this security are being restricted and excluded from its use. That does not, to us, make sense.

We understand the choices have to be made in these budget times, but let us not kid ourselves. The choices will definitely have an impact on who gets leveraged. We are not fearful of change and we support growth. However, the recommendations that we have submitted to you, that you alluded to, from our NAIC recommendations, as well as the advisory council set up by SBA—whose final report, by the way, I received yesterday and I believe the Committee will be receiving, if it has not, very, very shortly—would suggest that—we would certainly hope that they would become a part of the deliberations because that was a thoughtful year-long study that, I think, really addressed a lot of the issues.

I will conclude by saying prospectively, trying to run through the points and directing my comments directly to the legislation, prospectively we are also recommending that there be a single license category. This is because we do not have leverage anyway and we think it is basically unfair to impose restrictions on who we can invest in if, in fact, the mandate to fund this SSBIC portion is not funded.

In addition, we believe that the people and the managers who will focus on our marketplace will do so in any event.

The statutory minimum capital requirement being proposed of \$5 million, we think is a mistake because again it does not really relate to the reality of assets under management, as opposed to private capital. We believe that \$2.5 million in minimum capital can, in fact, be viable and has been shown to be viable and that the SBA has mechanisms in place now to determine whether or not one is viable.

Often what happens is that these funds are adjuncts to other funds or other activities, so that the burden of carrying these funds can, in fact, be carried by smaller funds of \$2.5 million, which we think is the reasonable minimum capital to target the market that is really unserved.

We believe there should be incentives to flow capital from, as you mentioned Senator Bond, from SBICs of all sizes to the smaller end of the scale profitably, rather than requiring SBICs to have a minimum portfolio of 25 percent of these funds. Do it the other way, incentivize everybody to invest in that segment by a variety of strategies.

We believe in safety and soundness, but the assumption that bigger is better is just not borne out by the facts. In fact, even though you mentioned the 4 percent of the, I guess, private capital you

said is in the form of the \$2.5 million and under funds, the number of transactions done, if we did that analysis, in this country for small businesses by that segment is probably a substantial percentage of the number of transactions done by the SBIC industry.

In fact, losses in this program, if one were to do the analysis from larger funds, would probably on a dollar volume basis—which is really the bottom line to the taxpayers—equal or exceed those from those smaller funds. So I am not sure that bigger is better.

If these proposals are enacted, they should be done so prospectively. People operating funds successfully, as has been mentioned by Ms. Forbes, should not be penalized.

To conclude, leverage of four-to-one is theoretical, it is not actual. There are almost no—very few SBICs or no SBICs that have 4-to-1 leverage. The pool you mentioned, in fact, has leverage—the licensees under \$2.5 million have leverage of approximately 2 or 2.2-to-1, and licensees under \$1.5 million in private capital are leveraged at a rate of about 1.5-to-1. So that risk that you mentioned, I think, needs to be looked at carefully.

We welcome a dialog on these issues. We are open as well, but we think that clearly the marketplace and the rationale for this program is to serve smaller businesses, entrepreneurial businesses, and not to compete with the venture capital industry that exists.

Thank you.

[The prepared statement and attachments of Mr. Jones follow:]



## STATEMENT OF TERRY L. JONES

Mr. Chairman and Members of the Committee, my name is Terry L. Jones. I am President of Syncom Capital Corporation ("Syncom Capital"), an SSBIC which focuses on investments in the telecommunications industry.

Syncom Capital received its SSBIC license in 1978 and began with \$1.25 million of private capital. Since its inception some 18 years ago, Syncom Capital has invested approximately \$18 million in 52 transactions either individually or as an investor with a group of SSBICs or other private investors. These transactions leveraged \$373 million in total capital for an underserved part of the American small business marketplace.

Syncom Capital is but one of 4 investment funds which my partners and I manage. In addition to the SSBIC, we have received \$55 million from institutional investors, mostly public and private pension funds including, for example, CALSTRS, Teachers Insurance Annuity Fund and Ameritech. Today, collectively, my partners and I manage approximately \$100 million in assets.

I am also the Chairman of the National Association of Investment Companies ("NAIC") which is the trade association of SSBICs, SBICs and private venture capital funds who have a minority-focused investment policy. The preponderance of NAIC members are SSBICs who are located and/or have financed small businesses in nearly all of the states represented by the Members of this Committee.

Since the Committee's SBIC legislative proposals, as reflected in a draft bill dated May 2, have only been available for a short period of time, my comments today will be relatively brief. NAIC's Legislative Committee has begun an extensive review of the proposals and we respectfully request the opportunity to submit our detailed comments for the record in several days. Today, I want to address what we believe are the most serious issues and basic questions which should be resolved.

Mr. Chairman, SSBICs were authorized as part of the SBIC program to provide patient capital to an underserved part of the American small business marketplace. As you know, SSBICs invest in small firms owned by persons who are socially or economically disadvantaged, interpreted to mean ethnic minorities or persons who are disadvantaged due to some characteristic such as gender or educational background. Although regular SBICs can invest in such firms, historically (with very few exceptions) they have not done so. Thus, SSBICs have literally been the sole source of patient capital to this market. Clearly, whatever the problems small businesses experience in accessing patient capital, they are magnified many times over for minority entrepreneurs. For example, in a recent Wall Street Journal survey of 472 minority business owners, 95 per cent of those surveyed said access to credit and capital was their most pressing problem.

It is important to note that managers of SSBICs (and other minority-focused venture funds) have changed the character of minority business over the past two decades. Often working together in syndicates, the types of financings have continued to evolve into sophisticated investments in such fields as computer technology, telecommunications, manufacturing, health care, multi-unit franchises and wholesaling. Our investment managers are tapping entrepreneurs with the management, marketing and financial skills required to successfully grow their firms. As alluded to earlier, these investments have been throughout the country. Attached to my testimony are several exhibits which illustrate this trend and the types of investments that have been made.

Exhibits 1-6 are taken from a survey concluded by NAIC in 1991 in connection with our efforts in the creation of a minority-focused "Fund-to-Funds", Fairview Capital (which successfully closed 18 months ago with \$100 million in commitments from major institutional investors). The data in these exhibits is based on transactions completed by 16 SSBICs between 1981 and 1991. Although not a large scale study, the sampling shows a range of investments that represent racial and ethnic diversity and different geographic locations.

Exhibit 7 presents a small sample of 14 companies that were financed by SSBICs during the period 1981-1991. The sample is illustrative of SSBIC investment trends over the last decade and a half and which shows the increasing sophistication and diversity of SSBIC investments.

Thus, in discussing and evaluating the impact on SSBICs of legislative proposals, the Committee is really talking about the extent to which the kind of patient, equity-type, capital that SSBICs have traditionally provided to small businesses in general, and to minority entrepreneurs in particular, will continue to be available as an integral part of the SBIC program.

Mr. Chairman, I want to emphasize this last point. Before acting on any legislation, the Committee must clearly answer some basic questions:

- First and foremost, is there still a need for a government-sponsored small business venture capital program? That is, is there still a compelling public policy interest which can be addressed through the SBIC program?
- Second, the Committee should directly address the question of whom the SBIC program is meant to serve. That is, in 1996, what is meant by the phrase "small business" and what is the typical size of investment that is envisioned? Given that the median private venture capital fund that closed in 1994 was \$50 million, do the current program regulations and this draft legislation create an SSBIC program which is in effect competing with conventional private equity funds?

Mr. Chairman, the answers to these questions will determine to a large degree who will be allowed to receive and retain a license in the future. Moreover, the answers to these questions will determine the most appropriate form of Federal financial assistance or leverage which should be made available.

As you review the exhibits to which I referred earlier, you will note that the average size of each investment is approximately \$200,000. Many of these very viable businesses could only be financed because SSBIC managers understand the marketplace and because a patient, equity-type form of leverage (i.e. preferred stock leverage), was available. Thus, NAIC is very disappointed that the Administration's Fiscal Year 1997 budget does not request SSBIC preferred securities or subsidized debenture leverage. The Administration justifies this on the basis of the subsidy rates assumed for these forms of leverage. However, these budget priorities do not change the fact that there is still a tremendous shortage for this market segment served by SSBICs.

What's more, in 1991, an SBA-sponsored advisory council recognized the absolute necessity for equity-type leverage for SBICs. Hence the recommendation to create participating security leverage. It is ironic that this new security which was developed to address the debenture debt burden of existing SBICs (most of whom had private capital of less than \$10 million) but this form of leverage has been restricted to those funds with more than \$10 million in private capital.

NAIC recognizes that choices must be made and lines drawn which, in these budget times, may not be easy or desirable. But let's not kid ourselves. These choices will most definitely have an impact on who gets capital and who doesn't.

Mr. Chairman, SSBIC managers are not fearful of change and we are mindful of budget realities. We support the growth of the program and we encourage our members to take on the challenge of raising new capital.

Some SSBIC manager seek to grow their existing funds or, as Syncom has done, are raising new funds outside the programs. Others have more modest ambitions. If providing patient capital to minority entrepreneurs is still one of the goals of the SBIC program, all we seek is consistency, fairness and the financial tools to carry out the mission.

NAIC has made specific recommendations concerning SSBIC participants in the SBIC program to the SSBIC Advisory Council set up by SBA. Copies of the Association's recommendation have been previously provided to this Committee. We urge you to solicit the Council's input as part of your deliberations, as was the case with the SBIC Advisory Council prior to the 1992 Amendments to the Small Business Investment Act (SBIA) which among other things created participating securities.



Prospectively, we are recommending that there should be a single category of license. If traditional SSBIC leverage is not going to be made available, then SSBICs should be freed from the investment restriction under Section 301(d) of the SBIA. Our members are committed to the minority business market niche, but it is fundamentally unfair to impose an unfunded mandate upon us.

We believe that the statutory minimum capital needed for a new license should remain at the current \$2.5 million level and that leverage incentives should be designed to flow patient capital to "smaller entrepreneurial concerns" (SECs) regardless of the race or ethnicity of the owners. (We would define SECs as firms with \$1 million net worth and \$500,000 after-tax net income.) Given the historic purpose of the SBIC program, NAIC believes that public policy should recognize, encourage and reward those licensees that, by virtue of their investment strategy, choose to predominately finance SECs. That encouragement at a minimum should be reflected in a policy that reserves a threshold leverage allocation for such licensees.

We also believe that licensees with \$5 million in private capital should be able to apply for participating securities leverage. Current SBA regulations at least provide for this possibility and we oppose a \$10 million statutory minimum for this form of leverage.

Mr. Chairman, your letter of invitation to me states that the Committee proposals are designed to enhance the "safety and soundness" of the SBIC program. I do not disagree that there is some threshold level of capital required to successfully operate an investment company. However, the assumption that "bigger" is always better and safer and conversely "smaller" is always inherently more risky, is not well founded. Prior to 1992, losses in the SBIC program occurred in licensees of all sizes and I believe were more a function of management skill and integrity than size.

Mr. Chairman, if changes are to be enacted, it is critical that they be done so prospectively. Those licensees, whether SSBICs or SBICs, who are in regulatory compliance and who operate successfully, should not be penalized. The Committee's discussion draft would take away a company's license if by December 31, 1997 its private capital was not at least \$2.5 million.

NAIC opposes this provision in the strongest terms. We do not understand why a company which is operating successfully and providing capital to small businesses should be put at risk of losing its license. It is wrong, unfair, would set a terrible precedent, and would have a chilling effect on potential applicants and investors. This provision would put directly and adversely affect 80% of all SSBICs and a great number of SBICs. No matter if unintended, this provision would have a devastating impact on minority business. Further, the draft would restrict a large segment of licensees to financing "micro-enterprises" as defined in the draft, rather than provide incentives for SBICs of all sizes to direct capital at this underserved segment of the small business marketplace. Frankly, Mr. Chairman, this is the only reason the federal government should be involved in the venture capital industry today.

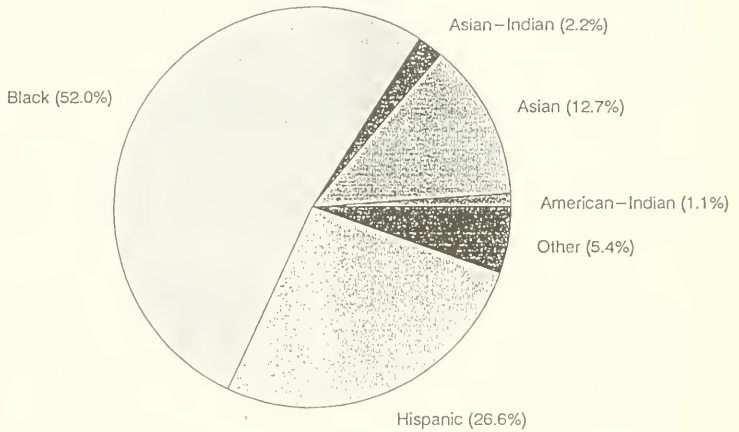
Mr. Chairman, NAIC welcomes a meaningful dialogue on these issues. Let us be honest with each other and move forward toward creating a program which will continue to provide patient, equity-type capital to viable, but underserved, small businesses throughout America.

## EXHIBIT 1

# Investments By Ethnic Group

January 1, 1981 to June 30, 1991  
(16 Investment Firms)

| Ethnic Group    | Total (\$)  | Percent of Total | Average (\$) | Minimum (\$) | Maximum (\$) | Number |
|-----------------|-------------|------------------|--------------|--------------|--------------|--------|
| American-Indian | 1,247,291   | 1.1%             | 138,588      | 8,000        | 307,791      | 9      |
| Asian           | 14,478,116  | 12.7%            | 159,100      | 8,000        | 2,000,000    | 91     |
| Asian-Indian    | 2,487,474   | 2.2%             | 108,151      | 6,736        | 300,012      | 23     |
| Black           | 59,243,894  | 52.0%            | 194,881      | 3,000        | 2,000,000    | 304    |
| Hispanic        | 30,303,880  | 26.6%            | 170,247      | 1,000        | 3,393,160    | 178    |
| Other           | 6,094,963   | 5.4%             | 126,978      | 16,549       | 440,000      | 48     |
|                 | 113,855,618 | 100.0%           | 174,358      | 1,000        | 3,393,160    | 653    |

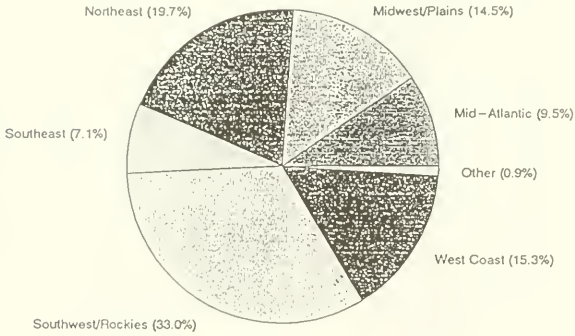


Other includes Egyptian, Russian, Haitian, Arab, Romanian and Handicapped

# Investments By Region

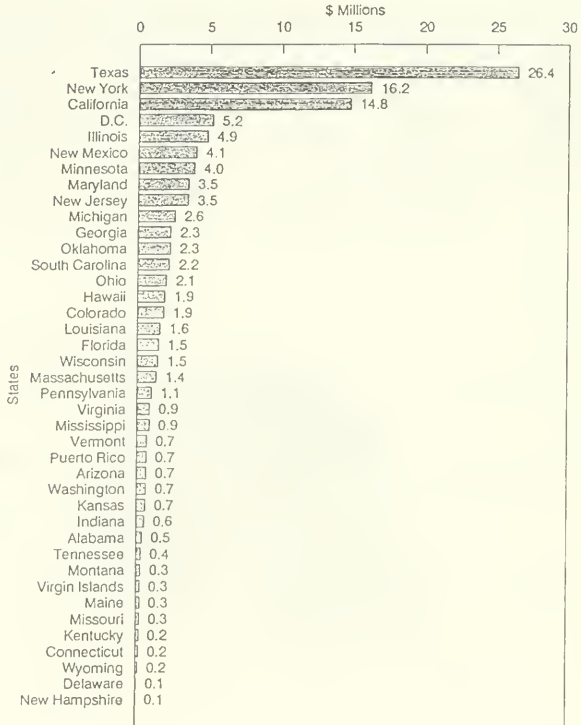
January 1, 1981 to June 30, 1991  
(16 Investment Firms)

| Region            | Total (\$)  | Percent of Total | Average (\$) | Minimum (\$) | Maximum (\$) | Number |
|-------------------|-------------|------------------|--------------|--------------|--------------|--------|
| Mid-Atlantic      | 10,658,914  | 9.5%             | 350,288      | 5,000        | 2,000,000    | 31     |
| Midwest/Plains    | 16,497,874  | 14.5%            | 189,631      | 4,500        | 2,000,000    | 87     |
| Northeast         | 22,458,395  | 19.7%            | 147,753      | 3,000        | 731,690      | 152    |
| Southeast         | 8,062,868   | 7.1%             | 212,181      | 6,736        | 750,000      | 38     |
| Southwest/Rockies | 37,533,955  | 33.0%            | 148,356      | 1,000        | 2,100,000    | 253    |
| West Coast        | 17,420,774  | 15.3%            | 197,963      | 8,000        | 3,393,160    | 86     |
| Other             | 1,022,838   | 0.9%             | 255,710      | 47,838       | 600,000      | 4      |
|                   | 113,855,618 | 100.0%           | 174,358      | 1,000        | 3,393,160    | 653    |



Other includes Puerto Rico and Virgin Islands.

**Investments By State**  
**January 1, 1981 to June 30, 1991**  
 (16 Investment Firms)



# Investments By State

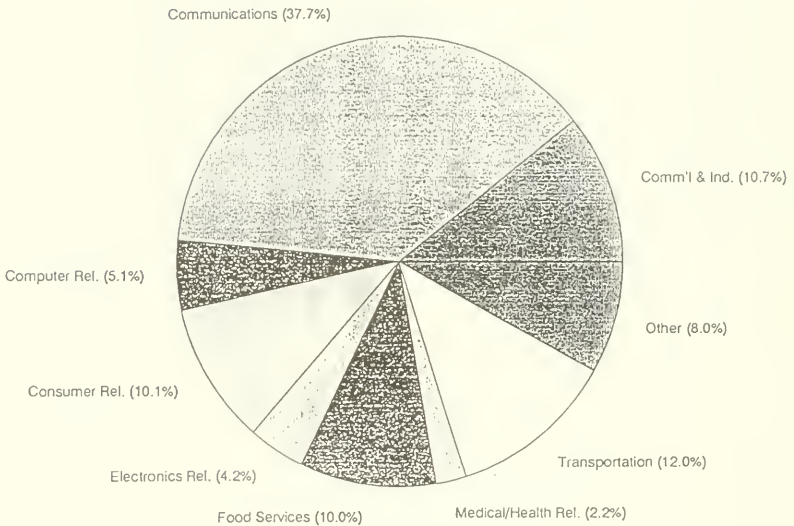
January 1, 1981 to June 30, 1991  
(16 Investment Firms)

| State          | Total (\$)  | Percent of Total | Average (\$) | Minimum (\$) | Maximum (\$) | Number |
|----------------|-------------|------------------|--------------|--------------|--------------|--------|
| Texas          | 26,414,851  | 23.2%            | 145,137      | 1,000        | 2,100,000    | 182    |
| New York       | 16,245,985  | 14.3%            | 138,855      | 3,000        | 600,004      | 117    |
| California     | 14,603,593  | 13.0%            | 255,234      | 8,000        | 3,393,160    | 58     |
| D.C.           | 5,208,110   | 4.6%             | 400,624      | 5,000        | 2,000,000    | 13     |
| Illinois       | 4,866,255   | 4.3%             | 115,863      | 4,500        | 515,000      | 42     |
| New Mexico     | 4,084,243   | 3.6%             | 136,141      | 10,000       | 987,241      | 30     |
| Minnesota      | 3,952,500   | 3.5%             | 564,643      | 160,000      | 2,000,000    | 7      |
| Maryland       | 3,546,000   | 3.1%             | 591,000      | 75,000       | 1,900,000    | 6      |
| New Jersey     | 3,515,720   | 3.1%             | 159,805      | 25,000       | 400,001      | 22     |
| Michigan       | 2,603,002   | 2.3%             | 200,231      | 8,000        | 862,000      | 13     |
| Georgia        | 2,316,306   | 2.0%             | 231,631      | 10,000       | 750,000      | 10     |
| Oklahoma       | 2,306,581   | 2.0%             | 256,287      | 50,000       | 1,000,000    | 9      |
| South Carolina | 2,249,909   | 2.0%             | 224,991      | 15,000       | 667,909      | 10     |
| Ohio           | 2,062,972   | 1.8%             | 343,829      | 150,000      | 856,477      | 6      |
| Hawaii         | 1,937,181   | 1.7%             | 77,407       | 16,549       | 160,000      | 25     |
| Colorado       | 1,880,829   | 1.7%             | 125,389      | 8,000        | 400,000      | 15     |
| Louisiana      | 1,624,949   | 1.4%             | 232,136      | 50,000       | 350,000      | 7      |
| Florida        | 1,532,653   | 1.3%             | 170,295      | 6,736        | 450,000      | 9      |
| Wisconsin      | 1,477,640   | 1.3%             | 134,331      | 15,000       | 250,000      | 11     |
| Massachusetts  | 1,380,000   | 1.2%             | 172,500      | 80,000       | 400,000      | 8      |
| Pennsylvania   | 1,064,844   | 0.9%             | 177,474      | 53,844       | 286,000      | 6      |
| Virginia       | 939,960     | 0.8%             | 187,992      | 15,000       | 300,000      | 5      |
| Mississippi    | 915,000     | 0.8%             | 305,000      | 100,000      | 450,000      | 3      |
| Vermont        | 731,690     | 0.6%             | 731,690      | 731,690      | 731,690      | 1      |
| Puerto Rico    | 722,838     | 0.6%             | 240,946      | 47,838       | 600,000      | 3      |
| Arizona        | 718,502     | 0.6%             | 119,750      | 22,807       | 243,195      | 6      |
| Washington     | 680,000     | 0.6%             | 136,000      | 25,000       | 250,000      | 5      |
| Kansas         | 661,069     | 0.6%             | 220,356      | 100,000      | 300,000      | 3      |
| Indiana        | 584,050     | 0.5%             | 194,683      | 96,050       | 300,000      | 3      |
| Alabama        | 450,000     | 0.4%             | 225,000      | 150,000      | 300,000      | 2      |
| Tennessee      | 360,000     | 0.3%             | 180,000      | 60,000       | 300,000      | 2      |
| Montana        | 330,000     | 0.3%             | 165,000      | 35,000       | 295,000      | 2      |
| Virgin Islands | 300,000     | 0.3%             | 300,000      | 300,000      | 300,000      | 1      |
| Maine          | 300,000     | 0.3%             | 300,000      | 300,000      | 300,000      | 1      |
| Missouri       | 290,386     | 0.3%             | 145,193      | 45,193       | 245,193      | 2      |
| Kentucky       | 239,000     | 0.2%             | 119,500      | 55,000       | 184,000      | 2      |
| Connecticut    | 235,000     | 0.2%             | 117,500      | 117,500      | 117,500      | 2      |
| Wyoming        | 174,000     | 0.2%             | 87,000       | 4,000        | 170,000      | 2      |
| Delaware       | 100,000     | 0.1%             | 100,000      | 100,000      | 100,000      | 1      |
| New Hampshire  | 50,000      | 0.0%             | 50,000       | 50,000       | 50,000       | 1      |
|                | 113,855,618 | 100.0%           | 174,358      | 1,000        | 3,393,160    | 653    |

# Investments By Industry

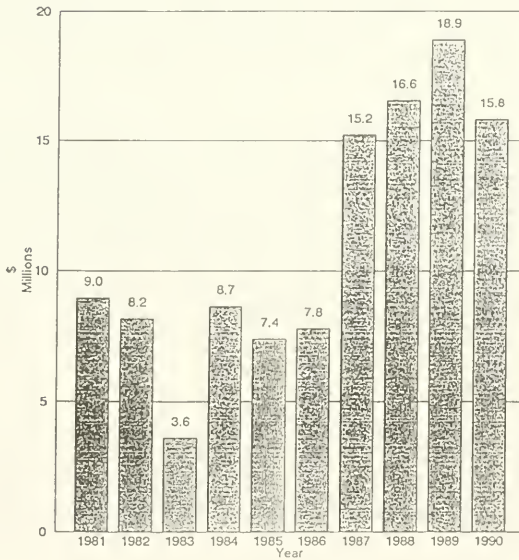
January 1, 1981 to June 30, 1991  
(16 Investment Firms)

| Industry                       | Total (\$)  | Percent of Total | Average (\$) | Minimum (\$) | Maximum (\$) | Number |
|--------------------------------|-------------|------------------|--------------|--------------|--------------|--------|
| Commercial/Indust. Prod./Serv. | 12,224,215  | 10.7%            | 137,351      | 4,500        | 495,000      | 89     |
| Communications                 | 42,903,435  | 37.7%            | 284,129      | 8,000        | 3,393,160    | 151    |
| Computer Related               | 5,780,906   | 5.1%             | 148,228      | 8,000        | 400,000      | 39     |
| Consumer Related               | 11,551,401  | 10.1%            | 129,791      | 6,736        | 600,000      | 89     |
| Electronics Related            | 4,730,753   | 4.2%             | 118,269      | 5,250        | 450,000      | 40     |
| Food Services                  | 11,365,548  | 10.0%            | 174,855      | 5,000        | 2,000,000    | 65     |
| Medical/Health Related         | 2,480,700   | 2.2%             | 248,070      | 52,667       | 500,000      | 10     |
| Transportation                 | 13,676,552  | 12.0%            | 143,964      | 3,000        | 1,800,000    | 95     |
| Other                          | 9,142,108   | 8.0%             | 121,895      | 1,000        | 1,016,750    | 75     |
|                                | 113,855,618 | 100.0%           | 174,358      | 1,000        | 3,393,160    | 653    |



**Investments By Year**  
**January 1, 1981 to June 30, 1991**  
 (16 Investment Firms)

| Year | Total (\$)  | Average (\$) | Minimum (\$) | Maximum (\$) | Number |
|------|-------------|--------------|--------------|--------------|--------|
| 1981 | 8,965,155   | 298,839      | 33,000       | 3,393,160    | 30     |
| 1982 | 8,162,532   | 215,330      | 4,500        | 1,067,374    | 38     |
| 1983 | 3,593,446   | 112,295      | 8,000        | 350,000      | 32     |
| 1984 | 8,661,789   | 188,300      | 1,000        | 862,000      | 46     |
| 1985 | 7,400,742   | 176,208      | 8,000        | 600,000      | 42     |
| 1986 | 7,799,044   | 129,984      | 5,000        | 856,477      | 60     |
| 1987 | 15,241,895  | 175,194      | 4,000        | 2,100,000    | 87     |
| 1988 | 16,571,267  | 190,474      | 10,000       | 2,000,000    | 87     |
| 1989 | 18,891,156  | 164,271      | 3,000        | 1,000,000    | 115    |
| 1990 | 15,844,436  | 172,222      | 5,000        | 1,900,000    | 92     |
| 1991 | 2,704,157   | 112,673      | 8,000        | 400,000      | 24     |
|      | 113,855,618 | 174,358      | 1,000        | 3,393,160    | 653    |





Companies Receiving Investments from  
Minority Venture Capital Companies

**Alamo Technologies**

In 1981, four Hispanic engineers founded Alamo Technologies, a company that specializes in providing engineering services for the government. Alamo Technologies is based in San Antonio, Texas, a city which serves as home to five military bases. In 1987 MESBIC Ventures, Inc. and four other minority investment companies provided several rounds of financing to Alamo Technologies, which at the time had reached sales of approximately \$3 million and had just won a \$16 million contract with the government to design and manufacture a jet engine set. This test has received recognition for its overall efficiency. On most tests this set uses 50% less fuel and 50% less time and labor.

MESBIC Ventures and the four other investment companies provided over \$1.5 million in financing to Alamo Technologies, which is currently doing \$6 million annually in revenues, has substantial net worth and profitability, and is ranked by Hispanic Business as the sixth largest Hispanic-owned engineering company. The entrepreneurs and investors see Alamo Technologies as a leading candidate to grow to a \$25 million company, providing capital can be secured to match the human talent already in place.

With the financing from the investment companies, Alamo Technologies has over the past three years brought the engine test sets into full production and is manufacturing 250 test sets per year. The company also built prototypes to conduct field test, two of which provided critical assistance during the Desert Storm operation. Given the success of the engine test sets, Alamo Technologies is currently developing plans for commercial applications and seeks additional venture capital to build a commercial test set by the mid-1990s. In addition, the company created a unique, totally automated software system in developing the engine test sets, and is developing software to provide services for other types of equipment.

**Almic Broadcasting, Inc.**

In 1980, SYNCOM Capital Corporation led the first in a series of investments in Almic Broadcasting, Inc. that are helping to build a highly successful broadcasting company based in Washington, DC. Owned by entrepreneurs Cathy Hughes and her son, Alfred Liggins, Almic Broadcasting in 1980 purchased WOL-AM, a premiere radio station in the Washington area's Black community. SYNCOM was the lead investor in a syndicated deal involving several other minority investment companies.

In 1987 SYNCOM served as lead investor for Almic's purchase of WMMJ-FM from The Outlet Company for \$7.5 million. Almic paired the AM and FM stations, converted WMMJ's adult contemporary format to upscale urban, and turned the AM/FM combination into the number one station in Washington, DC for people aged 25 - 54, the most desirable demographics for

advertisers. The company has gone from zero revenue, zero cash flow in 1987 to close to \$7 million revenue and almost a \$1 million cash flow.

Almic is currently in the process of buying an FM/AM combination in Baltimore, Maryland. The growth in the values of the Washington, DC properties has been instrumental in Almic being able to leverage the acquisition of the Baltimore stations, further enhancing the value of the company.

The investors are also realizing some return on investment at this point. Almic is repurchasing about 20% of SYNCOM'S warrants, and the investors are also realizing returns on debentures. The company is currently worth an estimated \$17 – 20 million, despite today's down market.

### **Envirotest Systems Corporation**

In December, 1990, Envirotest Systems Corporation acquired Hamilton Test Systems, a leading provider of motor vehicle emission testing systems and services, from United Technologies. The company designs, installs and operates centralized motor vehicle testing facilities on a contract basis in states and municipalities around the country. Envirotest Systems currently tests vehicles in Connecticut, Ohio, and Wisconsin, and in January 1991, shortly after the acquisition of Hamilton Test Systems, it won a contract through competitive bidding to conduct all motor vehicles emission testing in Vancouver, British Columbia.

Black entrepreneur Chester Davenport formed Envirotest Systems Corporation for the purpose of acquiring Hamilton Test Systems from United Technologies. The equity part of financing the \$43 million deal was provided by Georgetown Partners, a buyout fund which Davenport created, and an investment group led by Equico Capital Corporation, a New York-based minority investment company. A major international bank provided the bank financing. Davenport, an attorney and former Deputy Assistant Secretary of the U. S. Department of Transportation, was a successful real estate entrepreneur in the Washington, DC metropolitan area prior to establishing his Bethesda, Maryland-based buyout fund.

Envirotest Systems Corporation is currently negotiating to acquire a significant competitor in the motor vehicles emission testing business. If the deal is consummated, the company will hold a superior position in the industry and the economies of combining the two companies will enhance its profitability.

### **Tennessee Double Drive Thru (Checkers of North America)**

In November, 1991, the Combined Fund, Inc. closed a \$1 million syndicated financing in Tennessee Double Drive Thru, a company formed by Black entrepreneur John Perry to develop five Checkers of North America franchise operations in Memphis, Tennessee. Checkers restaurants are double drive through fast food restaurants that sell hamburgers, French fries, fish

and other fast foods. The franchisor, Checkers of North America, headquartered in Clearwater, Florida, just went public in order to raise funds for expanding franchise operations. The Combined Fund, Inc. provided \$300,000 of the \$1 million syndicated financing for Tennessee Double Drive Thru. The Combined Fund has 40% potential equity interest in the company, and entrepreneur John Perry has the balance.

A veteran in the fast food industry, Perry previously owned the 87th Street Corporation, which bought and sold three McDonald's restaurants over a period of a decade and a half and provided numerous jobs to inner city young people. All three McDonald's were profitable operations. The Combined Fund began investing in Perry in 1975, providing \$250,000 in financing and bringing in an additional \$500,000 from other sources. Perry determined that the growth potential of McDonald's was flat, especially compared to Checkers of North America which some analysts expect to be the number one double drive through restaurant in America within the next three years. Perry sold his last McDonald's property in May, 1991.

#### Education Alternatives, Inc.

In 1988, Education Alternatives, Inc. was founded to develop and operate proprietary private schools. Prior to the company's public offering (NASDAQ tracking symbol EAIC) in 1990, Capital Dimensions Venture Fund, Inc., another SBIC and a group of private investors provided \$4.5 million of equity and an additional \$1 million in other bank and public borrowing. The two minority investment companies put in \$700,000 in preferred stock in 1988, and an additional \$80,000 in debt guarantees in 1990. Hispanic entrepreneur Frank Martin was the founder of the company.

Education Alternatives, known nationally for its pioneering work with Tesseract Schools, built and operated two private schools in the suburbs of Minneapolis and Phoenix. Students in the preschool through sixth grade schools advanced an average of 1.7 grades within a year with the Tesseract model's emphasis on individual students' learning styles. The teacher-student ratio is 1 to 12, a ratio achieved with economic feasibility through an innovative system of master teachers, junior teachers, and assistants. The schools also make maximum use of technology, an approach which is facilitated through a relationship with IBM.

The original two schools' education performance was not matched by their financial performance, and the adaptive company is now contracting with school systems to operate schools using the Tesseract methodology. Education Alternatives is operating schools in Dade County (Miami) and Tallahassee, Florida. An agreement is currently in discussion with Johnson Controls and KPMG Peat Marwick that will allow the three companies to bid on and assume management of entire school systems. Given the number of school systems in the country and the size of their budgets, Education Alternatives will not require deep penetration of the market to achieve profitability. The company has received widespread publicity through media such as ABC's "Good Morning America," "CBS This Morning," the Wall Street Journal, and numerous other media for its innovative and highly successful approach to education.

### TLC Group Inc.

In January of 1984, Equico Capital Corporation invested \$500,000 in TLC Group Inc. ("TLC"), a newly formed company owned by Reginald Lewis. Equico's investment took the form of a \$500,000 13% subordinated debenture. The terms also included a warrant to purchase 10% of the common stock of TLC. An option to purchase 10% of the common stock of any company acquired by TLC within two years of Equico's investment was also a part of the terms.

Equico's investment provided part of the equity for TLC's acquisition of the McCall Pattern Company ("McCall") in a leveraged buyout valued at \$22.5 million. McCall was the second largest producer of home sewing patterns. In the fiscal year prior to the acquisition, McCall reported sales of \$51.9 million and operating income of \$7.1 million.

TLC prepaid the \$500,000 subordinated debenture in December 1985 and in June 1986 agreed to repurchase its warrant and option for \$2.4 million. Equico received \$700,000 cash and a one-year note for \$1.7 million. The note was paid in December 1987. This transaction produced an internal rate of return of 128%

Subsequent to the acquisition and sale of TLC, entrepreneur Reginald Lewis acquired Beatrice International in a \$1 billion leveraged buyout, the largest LBO ever conducted by a minority investor group. Lewis' McCall Pattern Company deal, which secured half of its equity from Equico Capital Corporation, served as the springboard for the Beatrice transaction.

### Emerge Communications, Inc.

In 1987, SYNCOM Capital Corporation began putting together a deal to invest in a start-up communications company that would own a news magazine targeted to the Black middle class. The concept for EMERGE Magazine was developed by Black entrepreneur/journalist Wilmer Ames, who was on the staff of Time Inc. when he conceived the idea and submitted it to Time Inc. in 1986. Time Inc. approached SYNCOM, the minority investment company which has financed the majority of minority-owned communications properties in the United States, as a potential partner in developing the magazine. SYNCOM agreed to conduct the analysis, structure the deal, and bring in investors.

In April, 1989 SYNCOM closed the deal, along with an investors group which includes Time Warner, Black Entertainment Television, Tower Ventures, Incorporated of Chicago, Opportunity Capital Corporation of Fremont, California, and Future Value Ventures, Inc. of Milwaukee, Wisconsin.

EMERGE Magazine is a monthly news magazine which is positioned to promote thought among the most influential members of the Black community. All EMERGE writers are Black freelance writers who cover issues and opinion makers that affect the Black community. Entrepreneur/journalist Wilmer Ames is Editor-in-Chief of EMERGE, and is also part owner.

Bob Johnson of Black Entertainment Television (BET) is the publisher. BET recently bought out Time Warner's share of EMERGE, and now owns 51% of the magazine. EMERGE published its first issue in October, 1989, and currently has a circulation of 120,000. It expects to achieve break-even by the end of 1992.

### Ninfa's

Between 1981 and 1991, MESBIC Ventures, Inc. of Dallas, Texas and several other minority investment companies have provided four rounds of financing for the expansion of Ninfa's, a restaurant chain based in Houston. Entrepreneur Ninfa Lorenzo began Ninfa's 25 years ago when customers of her popular flour tortilla stand urged her to open a restaurant. She started Ninfa's with a tortilla restaurant in the front of a Houston factory.

Today Ninfa's enterprise owns 30 stores and will do close to \$35 million in sales in 1991. Ninfa Lorenzo serves as chairman of the company, and the oldest of her four children, Naval Academy graduate and Vietnam War veteran Roland Lorenzo, is the president. The company operates three restaurant concepts. Ninfa's is a Mexican restaurant. Bambalino's, a restaurant with an Italian concept which was created by Ninfa and her children to honor her late husband (who was Italian) serves pizza and lasagna. Acchafalia's, named for a Louisiana waterway, has a Cajun theme.

Ninfa's, and the owner Ninfa Lorenzo herself, have become a legend in Houston. In fact, a local play was based upon the enterprising family, two of whose children are restaurant operators independent of the Ninfa's complex.

Following the original MESBIC Ventures financing in 1981, Ninfa's grew from \$18 million in sales to 1991's \$35 million. Three minority investment companies have provided close to \$1 million through four rounds of financing, including one in 1991 to create Bambalino's. The first round of financing was paid off in six years with a solid capital gain. The company is financially sound and profitable. It hopes to expand throughout Texas in the 1990's, providing at least \$2 million in venture capital can be secured.

### HR Industries

HR Industries, the largest Hispanic-owned company in the Southwest, is a turnaround company that grew from sales of near zero in 1983 and 1984 to sales today of \$12 million and 280 employees, most of whom are Hispanic. Hispanic entrepreneurs Paul Dickenson and Sam Moren, who founded HR Industries in the early 1970's, owned an oil company when they acquired a manufacturer of printed circuit boards in 1980. When the oil market fell apart in 1981 and the local economy crumbled in 1982-1983, the company was on the verge of failure. MESBIC Ventures, Inc. and three other minority investment companies provided financing to Dickenson and Moren to restart and restructure the company.

HR Industries has an automated state-of-the-art manufacturing process, and for the last five years has had substantial profitability. One of the largest printed circuit board companies in the industry, it is the largest Hispanic-owned electrical company in the country. Given the capital intensive requirements of the company's automated equipment, HR Industries anticipates a need for \$3 – \$5 million to continue its growth path in the 1990's.

#### **Micronics Computers Inc.**

Founded in 1986, Micronics Computers, Inc. is a leading designer, manufacturer and marketer of high performance, industry-standard microcomputer products. Micronics products include 80386 and 80486 system boards, portable computers and X-Terminals, based on the highest level of technology available. The company's product mix moved markedly toward the Intel 486SX–20 Mhz based product introduced in May, 1991. Micronics' products are marketed through two primary channels: (1) large PC manufacturers who use OEM Micronics' system boards in their brand name personal computers and (2) smaller VARs and System Integrators who use Micronics' boards as the basis of IBM PC/AT compatible systems.

With financing which includes Equitable Capital Corporation, a Chinese American-owned minority investment company based in San Francisco, Micronics has grown into a company that has been profitable every year since the company was founded. Under the management of Micronic's President, Frank Lin, dynamic growth and creative marketing strategies in 1988 resulted in a 525% increase in revenue to \$25 million from \$4 million the previous year. Micronics went public in July, 1991, and in its first quarterly report as a public company it reported that sales reached \$34,977,000 in the third quarter, up 64% from \$21,317,000 of sales in the previous year's third quarter. For the nine-month period, sales increased 66% to \$96,155,000 from the previous year, while net income was up 131%. The third quarter result represented the company's nineteenth consecutive profitable quarter.

#### **Pueblo Broadcasting Corporation**

In May, 1987, SYNCOM Capital Corporation and six other minority investment companies closed on a \$3.5 million deal to finance Pueblo Broadcasting Corporation's start-up of a Spanish language television station in the Houston, Texas market. The group of Hispanic entrepreneurs who had approached SYNCOM approximately four years earlier about structuring such a deal included a pharmacist, who became president of the company; a sales account manager from a Spanish language station in Los Angeles, who initially was the chief operating officer; a doctor; a shop owner; and other primarily professional Hispanic people. Upon SYNCOM's advice, the group sought a broadcast license for the station through the Federal Communications Commission's "comparative hearings" process, a lengthy and expensive process through which the FCC decides among multiple applicants for free licenses which best serves the public interest.



Upon receiving its license, the group returned to SYNCOM for assistance in structuring the deal. SYNCOM was joined in the syndicated financing by MESBIC Venture Capital, Inc. of Dallas; Intercontinental Capital Funding Corporation of New York; Venture Opportunities Corporation of New York; Fulcrum Venture Capital Corporation of Washington, D.C.; Opportunity Capital Corporation of Fremont, California; Associated Southwest Investors, Inc. of New Mexico; and Capital Dimensions Venture Fund, Inc. of Minneapolis. The group financed \$1.5 million in preferred stock for Pueblo Broadcasting. In addition, Capital Dimensions Venture Fund provided \$2 million senior debt financing, bringing total financing to \$3.5 million.

Station KXLN, Channel 45, went to a full power UHF Television station by 1988, and was the first Spanish language station to service the Houston community of one million documented Hispanic people. Its program services use Univision programming, as well as locally originated programming. The station was profitable from day one, earning \$250,000 in its first year as a low power station, and reaching nearly \$6 million in revenue in 1988 when it went to a full power UHF station. At the end of 1988 Hispanic Business named Pueblo Broadcasting the "Fastest Growing Hispanic Business in the United States." From a value of around \$6 million when it was financed, Pueblo Broadcasting grew within a year to a value of \$26 million. With two additional Spanish language stations now in the Houston market, Channel 45 remains the leading Spanish language station in Houston.

The minority investment company group in November, 1991 provided a substantial buyout of the entrepreneurs, resulting in a gain to the investors of \$3 million. The investor group retained 1% of equity at the request of the entrepreneurs, who wanted the investors to remain involved with the company.

#### **Cybernetics Systems International Corporation**

This Coral Gables, Florida corporation designs and markets automated workforce management systems. It structures and administers workplace schedules, for example, for companies such as airlines and hotels with large employee bases.

Cybernetics System International Corporation ("Cybernetics") develops and markets automated workforce management systems and software that control and administer intricate workplace schedules. The company was founded in 1980 by Claudio Mendoza and Gustavo Agusti, two Hispanic industrial engineers.

In March 1990, Equico invested \$400,000 of a total \$1.6 million in equity provided by three venture capital companies. The financing recapitalized the company and provided much needed capital for growth and new product development. During 1991 the venture group invested an additional \$500,000. Equico's share was \$145,000.

After a period of slow sales and unprofitability in late 1990 and early 1991, the company has signed major new contracts with Pacific Bell and the Florida State Department of Transportation.



Other significant customers include American Airlines, Northwest Airlines and American Express.

The recent market acceptance of the company's proprietary software should signal rapid growth. For 1992 Cybernetics is forecasting sales in excess of \$7.0 million and significantly increased profits.

### **Citywide Broadcasting Corporation**

In 1990, the Combined Fund, Inc., a minority investment company located in Chicago, began a series of investments in Citywide Broadcasting Corporation, a Louisiana-based broadcast company owned and operated by two Black entrepreneurs. Citywide Broadcasting Corporation currently owns three radio stations in Louisiana, including KOXL-FM and WXOK-AM in Baton Rouge and KFXZ-FM in Lafayette. The FM/AM combination is number one in the Baton Rouge market, with the combined audience base of the FM urban format and the AM news, rhythm and blues, and gospel format commanding 20% of the listener audience. KFXZ-FM is the number two station in Lafayette, commanding over 13% of the listening audience in its market.

The total investment in Citywide Broadcasting since 1990 totals \$2 million. The Combined Fund recently led an investment of nearly \$1 million, and has itself provided close to \$1 million in financing overall. The Combined Fund holds stock warrants in an amount of about 20 - 25% of the company. The funds have been used to refinance the Baton Rouge station and to acquire the Lafayette station. The Baton Rouge station has grown from a small Class A FM station, acquired by Citywide Broadcasting eight years ago with a value of \$500,000, to the AM/FM combination valued at close to \$8 million. Three years ago the station was upgraded to 50,000 watts. The three stations generate revenues of \$3.5 million, and are consistently profitable. The return on investment in Citywide Broadcasting is expected to exceed 40%

Peter Moncrieffe, President and General Manager of Citywide Broadcasting Corporation, and Bill Tucker, the two entrepreneurs who are building the company, were successful entrepreneurs in the construction and real estate businesses in Baton Rouge prior to entering the broadcast field. Their objective is to build Citywide Broadcasting into the number one broadcast company in Louisiana, building value through the growth of currently-owned stations and acquiring additional stations.

### **MultiRestaurants, Ltd.**

In 1989, MESBIC Ventures, Inc. and six other minority investment companies syndicated over \$4 million in equity financing for MultiRestaurants, Ltd. to acquire Key West Grill from Steak & Ale. Key West Grill, a restaurant concept described as "a seafood version of Bennigan's,"

currently has three restaurants in Texas and plans to expand in Texas and Florida. Key West Grill has an operating profit of 20%.

Hispanic entrepreneur Gilbert Aranza, President of MFVS, Inc., the managing general partner of MultiRestaurants, Ltd., created the concept for another of MultiRestaurant's holdings, a restaurant chain called J. Pepe's. Aranza founded J. Pepe's in 1982, and the upscale Mexican restaurant chain now has three stores. The Key West Grill and J. Pepe's operations have a combined \$9 million in sales.

Aranza, who worked his way through the University of Texas by working at the Dobbs House, Inc., a major airport restaurant operation, has a law degree from Harvard Law School and maintains a partnership role in the Dallas Law firm of Cohan, Simpson, Cowlishaw, Aranza & Wulff. Aranza and the investors have the objective of opening an additional 10 stores over the next five years in Texas and Florida, with emphasis on the profitable Key West Grill concept.

**SBIC/SSBIC LICENSEES UNDER \$2.5 MILLION PRIVATE CAPITAL  
SENATE SMALL BUSINESS COMMITTEE MEMBER STATES**

| <u>STATE</u>                        | <u>CITY</u>   | <u>DATE<br/>LICENSED</u> | <u>TYPE</u> | <u>PRIVATE<br/>CAPITAL</u> | <u>LEVERAGE<br/>FROM SBA</u> |
|-------------------------------------|---------------|--------------------------|-------------|----------------------------|------------------------------|
| <u>ALABAMA</u>                      |               |                          |             |                            |                              |
| Alabama Small Bus. Inv. Corp.       | Birmingham    | 04-05-88                 | SSBIC       | 1,005,000                  | 2,000,000                    |
| First SBIC of Alabama               | Mobile        | 07-20-78                 | SBIC        | 2,166,700                  | 5,950,000                    |
| Alabama Capital Corporation         | Mobile        | 07-28-81                 | SSBIC       | 1,550,000                  | 500,000                      |
| <u>ARKANSAS</u>                     |               |                          |             |                            |                              |
| Small Business Inv. Capital         | Little Rock   | 03-06-75                 | SBIC        | 1,150,000                  | 3,250,000                    |
| <u>CONNECTICUT</u>                  |               |                          |             |                            |                              |
| AB SBIC, Inc.                       | Cheshire      | 11-17-76                 | SBIC        | 1,000,000                  | 1,000,000                    |
| Financial Opportunities, Inc.       | Enfield       | 10-17-74                 | SBIC        | 1,900,000                  | 4,238,638                    |
| Marcon Capital Corp.                | Southport     | 10-23-75                 | SBIC        | 826,550                    | 2,400,000                    |
| Capital Resource Co. of Connecticut | West Hartford | 03-23-77                 | SBIC        | 1,570,000                  | 3,690,000                    |
| <u>GEORGIA</u>                      |               |                          |             |                            |                              |
| Renaissance Capital Corporation     | Atlanta       | 12-05-86                 | SSBIC       | 1,390,500                  | 2,070,000                    |
| First Growth Capital, Inc.          | Forsyth       | 11-16-89                 | SSBIC       | 1,060,000                  | 2,945,000                    |
| <u>MASSACHUSETTS</u>                |               |                          |             |                            |                              |
| UST Capital Corp.                   | Boston        | 10-06-61                 | SBIC        | 1,752,800                  | 0                            |
| Northeast SBI Corp.                 | Boston        | 05-07-74                 | SBIC        | 378,802                    | 1,130,000                    |
| Commonwealth Enterprise Fund Inc.   | Boston        | 05-28-92                 | SSBIC       | 1,500,000                  | 0                            |
| Argonaus MESBIC Corporation         | Framingham    | 06-17-88                 | SSBIC       | 1,140,237                  | 2,000,000                    |
| Business Achievement Corporation    | Newton        | 08-08-63                 | SBIC        | 550,000                    | 1,490,000                    |

| <u>STATE</u>      | <u>CITY</u>                         | <u>DATE<br/>LICENSED</u> | <u>TYPE</u> | <u>PRIVATE<br/>CAPITAL</u> | <u>LEVERAGE<br/>FROM SBA</u> |
|-------------------|-------------------------------------|--------------------------|-------------|----------------------------|------------------------------|
| <u>MICHIGAN</u>   | White Pines Capital Corporation     | 02-25-92                 | SBIC        | 1,750,000                  | 0                            |
|                   | Metro - Detroit Investment Co.      | 06-01-78                 | SSBIC       | 2,000,000                  | 6,000,000                    |
| <u>MISSOURI</u>   | Bankers Capital Corp.               | 02-12-76                 | SBIC        | 632,000                    | 710,000                      |
|                   |                                     |                          |             |                            |                              |
| <u>NEW JERSEY</u> | Transpac Capital Corporation        | 05-28-87                 | SSBIC       | 1,000,000                  | 2,698,000                    |
|                   | Capital Circulation Corporation     | 03-28-85                 | SSBIC       | 1,000,000                  | 2,000,000                    |
|                   | Tappan Zee Capital Corporation      | 11-16-63                 | SBIC        | 1,000,000                  | 2,700,000                    |
|                   | Rugers Minority Investment Co.      | 07-28-70                 | SSBIC       | 1,826,000                  | 0                            |
|                   | ESLO Capital Corp.                  | 05-31-79                 | SBIC        | 688,323                    | 1,030,000                    |
| <u>TENNESSEE</u>  | Valley Capital Corp.                | 10-08-82                 | SSBIC       | 1,145,000                  | 1,000,000                    |
|                   | West Tennessee Venture Capital      | 12-16-82                 | SSBIC       | 1,250,000                  | 0                            |
|                   | International Paper Cap. Formation  | 11-05-81                 | SSBIC       | 1,000,000                  | 1,000,000                    |
| <u>TEXAS</u>      | Tower Ventures, Inc.                | 06-30-75                 | SSBIC       | 1,764,616                  | 2,673,000                    |
|                   | North Texas MESBIC, Inc.            | 07-11-91                 | SSBIC       | 1,033,202                  | 3,100,000                    |
|                   | HCT Capital Corp.                   | 11-01-91                 | SBIC        | 2,125,000                  | 300,000                      |
|                   | United Oriental Capital Corporation | 07-07-82                 | SSBIC       | 1,700,000                  | 1,300,000                    |
|                   | Chen's Financial Group, Inc.        | 03-05-84                 | SSBIC       | 1,500,000                  | 3,000,000                    |
|                   | Charter Venture Group, Inc.         | 10-10-80                 | SBIC        | 1,685,000                  | 0                            |
|                   | Jardine Capital Corp.               | 12-22-86                 | SSBIC       | 1,550,000                  | 2,000,000                    |
|                   | MESBIC Financial Corp. of Houston   | 11-12-76                 | SSBIC       | 1,726,701                  | 1,679,000                    |
|                   | SBI Capital Corp.                   | 10-22-81                 | SBIC        | 2,256,000                  | 250,000                      |
|                   |                                     |                          |             |                            |                              |
|                   |                                     |                          |             |                            |                              |

| <u>STATE</u>                    | <u>CITY</u> | <u>DATE<br/>LICENSED</u> | <u>TYPE</u> | <u>PRIVATE<br/>CAPITAL</u> | <u>LEVERAGE<br/>FROM SBA</u> |
|---------------------------------|-------------|--------------------------|-------------|----------------------------|------------------------------|
| <u>VIRGINIA</u>                 |             |                          |             |                            |                              |
| Continental SBIC                | Arlington   | 10-19-90                 | SSBIC       | 1,200,000                  | 0                            |
| East West United Investment Co. | McLean      | 01-22-76                 | SSBIC       | 500,000                    | 1,000,000                    |
| <u>TOTAL SBIC (16)</u>          |             |                          |             | 21,431,175                 | 28,138,638                   |
| <u>TOTAL SSBIC (21)</u>         |             |                          |             | 27,841,256                 | 36,965,000                   |
| <u>TOTAL SBIC/SSBIC (37)</u>    |             |                          |             | 49,272,431                 | 65,103,638                   |

Chairman BOND. Thank you very much, Mr. Jones. We appreciate all of the comments, they are most helpful. Now let me turn to Mr. Harvey Granat.

**STATEMENT OF HARVEY L. GRANAT, PRESIDENT, STERLING COMMERCIAL CAPITAL, INC., GREAT NECK, NEW YORK**

Mr. GRANAT. Thank you, Mr. Chairman. Thank you, Senator Bumpers, and the Committee. I appreciate the opportunity to be here today and to continue to work in the partnership between the industry and your Committee and the agency to improve the soundness of the program and expand it.

I am here today with Walter Dick of Pioneer Ventures. We have combined our thinking on the written testimony, which you have, and while we have not had time to poll the membership, we believe that the testimony represents the thinking of our industry.

Chairman BOND. Thank you. Your full statement will be made a part of the record.

Mr. GRANAT. Thank you. Our company, Sterling Commercial Capital, is a privately-owned company with \$5 million of capital. We are in the process currently of raising additional capital. We exclusively use the subordinated debenture. You might be interested to know that the lion's share of our investments are in smaller businesses who meet the lower guideline of the \$6 million net worth, \$2 million net income, and our average investment is in the range of \$350,000 to \$500,000, although we do—with a fair amount of activity—go below that when we see an enterprising situation that we believe has the growth potential with the appropriate capital.

These are good small companies. We want to be able to assist them in their continued growth with future rounds of financing.

Your Committee's work, Mr. Chairman, and the passage of the 1992 legislation, has been crucial in what has been a healthy rebirth of our industry. I will not waste time because the remarks of Ms. Forbes were very adequate in the licensing activity and the enormous amount of private capital that has been attracted to this program.

What is important to note, though, with regard to those comments is the level of sophistication of the capital that is coming into this program. That is something that I think we can all take great comfort in. That leads to safety. That leads to soundness.

With higher capital requirements, with the very much higher professional investor credentials coming into the program and the tougher licensing procedures, the expectation is that our industry's results will shortly be in line with the favorable results of the venture capital industry.

Subsidy rates are already falling as a result of these new procedures and this tougher licensing. I would urge this Committee, as we view the subsidy rate issue, to keep closer surveillance on the next year as these existing regulations, tougher licensing, and better standards of admission into the program begin to take their effect.

As I said a moment ago, we exclusively use the debenture financing. It is a scarce commodity, as we are all aware of, and that is

alarming to us, particularly as we are out currently doing an equity raise.

As to the debenture financing, I do not think we can lose sight of the fact that it fills a major financing need of small companies who need capital. These companies are companies that are able currently to service the debt that would bespeak a level of a borrower who represents perhaps a little bit more safety in the program. We also think that it is an opportunity for the small business, utilizing this type of borrowing, this type of equity borrowing, to minimize their equity dilution and that is something that we ought to be protecting in this program.

For the licensee, it is an opportunity to better monitor the borrower through regularly scheduled current payments. I have been a lender for 35 years. Nothing is better than seeing a check come in every month or every quarter.

The June 1995 report of the SBIC Reinvention Council stated:

There is a large universe of many solid businesses that do not offer the home run potential for equity appreciation but which require debt in an amount beyond that available from conventional lenders. Large venture firms do not serve this market but SBICs do.

The SBIC program, Mr. Chairman, cries out for continued growth. There has been a great legislative and industry and agency marketing job done to attract this enormous pool of private capital. We cannot afford to lose the interest of those private investors based on unpredictability and unprojectionability.

We are out raising capital now and the most sophisticated of our prospective investors are deeply troubled by the questions of adequate government funding. It makes the raising of capital extremely difficult.

It is my fervent hope that in the days ahead we can work closely with you, and with the agency, to further define safety, soundness of the program through this Committee's proposed Small Business Investment Company Improvement Act of 1996 to assure its continued growth, and I thank you for the opportunity to be here.

[The joint prepared statement of Mr. Granat and Mr. Dick follows the oral presentation of Mr. Dick.]

Chairman BOND. Thank you very much, Mr. Granat.

Mr. Dick.

**STATEMENT OF C. WALTER DICK, VICE PRESIDENT, PIONEER CAPITAL CORPORATION, AND GENERAL PARTNER, PIONEER VENTURES, L.P. 1 AND PIONEER VENTURES, L.P. 2, BOSTON, MASSACHUSETTS**

Mr. DICK. Thank you, Chairman Bond, Senator Bumpers.

I am one of four partners in Pioneer Capital Corp. We manage two SBICs. One is a debenture SBIC and one is a participating security SBIC. We manage collectively \$60 million and, between the four of us—

Senator BUMPERS. Mr. Dick, if I may, with the Chairman's indulgence, stop you, are you limited to only one method of financing in each SBIC? You say you have one—

Mr. DICK. No, we are not.

Senator BUMPERS. Why have you done that?



Mr. DICK. We chose to have one as a debenture and one as a participating—

Senator BUMPERS. Why?

Mr. DICK. For the participating security SBIC, we went outside to raise private capital and the other one we funded with our own equity.

Senator BUMPERS. Thank you, Mr. Chairman.

Mr. DICK. May I add that time onto my 5 minutes?

Chairman BOND. You have got it back. Our hearings clerk is electronically capable. She can make those things happen.

Mr. DICK. Actually, I think I can come in under 5 minutes.

Our average deal size is \$900,000. All of our deals fit your so-called microenterprise earmarks in terms of size (that of less than \$6 million in net worth and less than \$2 million in profits). Our average investment of \$900,000 should be contrasted with a Coopers & Lybrand first quarter of 1996 average of \$2.7 million for all venture capital, so we are filling that gap.

The safety and soundness has improved dramatically due to the 1992 legislation and the overhaul in the SBIC rules and regs. We expect to work with you regarding the SBIC Improvement Act to further improve the program and reduce risk.

I have been asked, as an industry representative, to relay to you our thoughts and comments. We would like to compliment you on the work that you have done. We would like to reinforce that safety and soundness is in our best interest. And we also would like to give to you our commitment to work with you toward the goal.

I would like to also comment on the draft issues which we think may give us some concern. One of the areas is the third party debt and the second is the increased fees. The proposed legislation regarding third party debt positions SBA as a senior lender to all debt. This is not the original intention of the Act and I think it will create significant operating issues, particularly for the spread lenders and the debenture SBICs. It will reduce the flexibility of SBICs to react to the cash needs of their portfolio companies and, on a practical level I will give you an example.

If we would like to lease a copying machine, we will need to get the permission of the United States Government because the lessor will want to make sure that they have a first security interest on that copying machine. I just want you to know that it will have ramifications, I think, beyond what you may have been thinking in your draft proposal.

I would urge you to examine the rules and regulations because they represent decades of hands-on experience in wrestling with this particular issue. I would ask that you also, of course, take input from the industry in terms of crafting this portion of the bill.

The second area of concern are the fees. Under your draft legislative proposal, the user fee would go to 3 percent and the so-called interest rate, which we call a prioritized payment rate, would go up 50 basis points. The President's budget recommends a 1-percent increase in the priority rate, and as you may recall the Reinvention Council recommended a 250-basis point increase.

We have expressed our willingness to pay increased fees in exchange for increased levels of capital and an assurance of availabil-

ity of capital. I think the proposed level is already at the edge of driving perhaps returns below venture capital industry returns.

Why do I say that? The median venture capital return for the period 1969 to 1994, which represents \$22 billion of investment, was a net IRR of about 6 percent. The typical spread between the net IRR and a gross IRR is 6 percent. So the median, if you accept that assumption between gross IRR and net IRR, the industry median gross IRR is 12 percent. Our crossover point under the existing program is 11.5 percent. The crossover point is the rate at which our private capital partners benefit from SBA leverage.

Under your proposal, that crossover has been raised to 12 percent. Under the President's proposal it is 12.4 percent, and under the Reinvention Council it is 14 percent. What that means is that for our investors to benefit from this program we have to, on average, make investments that yield 12 percent compounded annually over the life of the partnership, which is 10 years. My fear is that by increasing the fees you will drive long-term capital out of the SBIC industry because the returns to the private capital partners will be decreased. I would urge you to keep the fees, assuming that is the alternative, keep the fees at the draft proposal level.

The program is crying out for growth and we need availability of capital. I am sorry, I would like to back up. I should also mention that on the fees, we have been in an unusually low-interest rate period. As interest rates move up, our crossover points and our break-even points also move up in lockstep fashion.

I am getting the yellow light, so I would like to thank you for your help. I would like to stress to you that we do need capital to grow, dependable capital. I think also that you should understand that a second tier of capital to participating security SBICs will reduce your risk and increase your returns.

In summary, this is a unique partnership. It is between small business, SBICs, and the Government, and we are committed to working with you to make this better. I would ask that you allow us to provide you with comment on the draft bill on or before May 22. Thank you.

[The joint prepared statement of Mr. Granat and Mr. Dick follows:]

Statement  
of  
Harvey L. Granat  
President  
Sterling Commercial Capital, Inc.  
and  
C. Walter Dick  
General Partner  
Pioneer Ventures, L.P.

#### A. Introduction

This testimony is presented jointly by Walter Dick, Vice President of Pioneer Capital Corporation of Boston, Massachusetts and Harvey Granat, President of Sterling Commercial Capital, Inc. of Great Neck, New York.

Pioneer Capital is the management firm for Pioneer Ventures L.P., a debenture SBIC licensed in 1986, and Pioneer Ventures L.P. II, a participating securities SBIC licensed in 1995. Total venture capital under management is approximately \$60 million. Mr. Dick and his partners have over 40 years of collective experience in both venture capital and the SBIC program. Mr. Dick has been involved in the SBIC program for 11 years and has made over 30 SBIC investments in Small Business Concerns.

Sterling Commercial Capital is a debenture SBIC that was licensed in 1988. Private capital totals \$5 million and Sterling has a total of \$20 million under management. Mr. Granat has over 35 years experience in both lending and venture investment.

We would like to commend Chairman Bond and the Senate Small Business Committee for taking the initiative to consider ways to further improve the Small Business Investment Company (SBIC) program. This committee's work in securing passage of the 1992 legislation was a crucial step in the current rebirth of the industry, and those of us in the industry look forward to working with you again to address issues that have been raised since that time. We appreciate the opportunity to give our views on the Staff Discussion Draft of the Small Business Investment Company Improvement Act of 1996 and look forward to working with the Committee and other industry representatives to craft a final bill which meets the needs of both Government and industry.

#### B. Background

Congressional action of 1992, only implemented in 1994, has resulted in the rebirth and substantial improvement of the program. The 55 new SBICs licensed in 1994 and 1995 have brought \$834 million in new private capital into the program, all to the advantage of small U.S. businesses. This is more private capital in less than two years than had been invested in the SBIC program in the previous 15 years. Additionally, SBIC license applications pending at SBA as of March 31, 1996 show the potential for another 76 SBICs with over \$1 billion more in private capital. Finally, with respect to the participating securities program, the Government has already received over \$250,000 in profits over and above its principal and prioritized payments and will likely receive another \$200,000 or more before the year is out. These profit payments to the Government have occurred years before originally projected and are a real indication of the strength of the SBIC program.

With respect to safety and soundness, we believe the SBIC program is healthier, more successful, and less costly to the Government than it has ever been in terms of providing long-term, patient capital to U.S. small businesses. Current Services subsidy rates used by OMB are falling as results attributable to the improved program begin to take hold, and we believe they will fall much further in the years to come. This means that in terms of appropriated funds, the SBIC program is truly doing "more with less." We have been told by SBA that if the increases in fees and interest proposed in the draft bill become operative, the FY'97 appropriation needed to drive the combined \$625 million program called for by the President will be \$35.8 million. That compares with FY'96's \$40.5 million appropriation driving a \$381 million program. The result would be a 12 percent decrease (\$4.7 million) in appropriated funds but a 64 percent increase (\$244 million) for investments in small businesses and the jobs and technologies they create.

The potential to help U.S. small businesses is great and that help is definitely needed. As recent House Small Business Committee hearings on access to capital have underscored, U.S. small businesses still have great difficulty raising the long-term patient capital they need to create the jobs and technologies that are the foundation of our country. Increasingly, non-SBIC venture capital is being consolidated in very large funds, making investments in the critical \$250,000 to \$3 million range impractical and uneconomical for large fund managers. This is the gap filled by SBICs. In addition, a greater percentage of U.S. venture capital than ever before is being invested overseas in non-U.S. companies. Because of the realities of the global economy, a large percentage of these foreign companies will compete with the same small U.S. companies that find it difficult to raise their required capital bases. The improved and growing SBIC program can be a balancing force in that equation if it is allowed to grow.

The President's SBIC budget proposes program levels of \$225 million for debentures and \$400 million for participating securities. We have endorsed the proposal as a step in the right direction, believing that they are the minimum levels required to support the revitalized and growing SBIC program. We hope that they will be supported by both Senate and House Small Business Committees. However, while we in the industry have endorsed the proposed levels, we note that the proposed debenture level will still fall as much as \$100 million short of meeting the need for leverage of just those debenture SBICs that are currently licensed. It would provide little or no leverage for new applicants, even those that already have committed private capital.

### **C. Small Business Investment Company Improvement Act of 1996: Comments on the Staff Discussion Draft**

With the above general comments, we turn now to a discussion of the provisions of the staff discussion draft legislation. In large measure we support the thrust of the draft, that of enacting provisions that will further strengthen the statutory foundation upon which the improved and rapidly growing SBIC program is based. We believe that many of our concerns may relate mostly to wording and that going forward from this point the Committee and industry representatives will be able to craft a final bill that will meet the needs of both.

**The following are provisions of the draft bill which we believe represent improvements to the program.**

**1. Matters considered in licensing.** Those of us who run SBICs are professional investment managers and are very supportive of requirements that potential SBIC managers be qualified insofar as the knowledge, experience and capability necessary to both comply with the rules and regulations governing the program and run a successful SBIC. The actions and results of one reflect on all and, at least with respect to subsidy rates, can affect all.

**2. Expedited license processing and the availability of leverage.** We in the industry want the SBIC program to grow in terms of numbers of and within reasonable licensing times. The 90 day period from point of completed application seems reasonable to us. SBA might be helped in reaching that point if it had the ability to use license application fees to outsource some of the licensing process and we urge the Committee to consider such application of the fees.

Notwithstanding the above, we think we should indicate that licensing significant numbers of new SBICs without addressing possible leverage shortfalls may affect private investors' views of the reliability of the Government as a limited partner that will meet its capital commitments and have safety and soundness ramifications. The availability of adequate leverage (two tiers) is of crucial importance to the SBIC program. Business plans used to raise required private capital

are based on projected availability of leverage. Additionally, it is the use of the leverage capital that permits portfolio diversification for the program and provides a reduction of risk to the Government, assuming at least some leverage is drawn down. Currently, the debenture program has insufficient leverage to meet demand from licensed SBICs. It is likely that this will continue even with the President's proposal for a substantial increase in the debenture program. This is why growth in the program is so important to those of us in the industry.

### 3. Minimum capital requirements.

a. The draft bill would codify the current regulatory minimums of \$5 million for leveraged debenture SBICs and \$10 million for participating security SBICs while removing the current flexibility to license an SBIC with less minimum capital (although not below statutory levels) if the applicant can demonstrate that it will be financially viable over the long term at the lower amount. These are the limits that most parties interested in the industry have accepted as being reasonable. From discussions with staff, we believe the intention is to apply the new minimum requirements only to SBICs eligible for leverage, thus leaving unchanged the requirements that would apply to bank SBICs. We think this is reasonable as well.

b. Whatever the changes in minimum capital going forward, we believe a "grandfather" clause should apply in almost all instances to existing licensees and license applicants of record. The SBIC program is a contractual partnership between private investors, applicants, and the Government. For various policy or practical reasons, it may be desirable to close a particular class of SBICs to potential new licensees. However, if existing smaller SBICs are operating soundly within the accepted norms of Regulation 107.220(c) and all other applicable regulations, it is unfair to apply the changes retroactively. We look forward to working with the Committee to strike the right balance.

c. Mandating that all "smaller" SBICs invest 100 percent of their funds in "microenterprises" may have a safety and soundness impact. While it is true that the smaller the fund the more likely that it will be investing in the smallest of small businesses, some flexibility would be desirable. Also, the definition of "smaller business" found in Section 107.710, which includes the draft bill's definition and the SIC size standards as an alternative, seems a good approach that the Committee might consider.

4. **Diversification of ownership.** We believe the draft bill intends to codify some of Section 107.150 of the current regulations and we would support that approach. We believe that some drafting changes are required with respect to associated or affiliated parties and with respect to cure provisions that should apply if an unforeseen event occurs which negatively impacts diversification.

5. **Material adverse changes.** We certainly concur that SBICs must notify the SBA of material adverse changes in the valuation of loans or investments or in the operations of SBICs. We suggest that the notification be pursuant to regulations promulgated by SBA. In this regard, we believe current regulations adequately cover issues related to material adverse changes.

6. **Trustee or receivership over licensee.** Discussions with staff lead us to believe that this provision will address issues related to maximizing returns on assets held in receivership in the event of an SBIC failure. Maximizing such returns is of significant importance to all involved with the SBIC program and we look forward to working with the Committee to craft a provision that will help achieve the results we all want.



**7. Penalties for noncompliance.** Until we see the proposed section we cannot respond directly. However, as a matter of policy, we agree that there should be adequate remedies and penalties related to noncompliance with SBIC laws and regulations. Current laws and regulations seem sufficient, but we will be happy to work with the Committee to ascertain whether or not some changes should be made.

**8. Investments by certain non-SBIC investment organizations.** This is an excellent provision that recognizes the fact that previous or contemporaneous investments by certain non-SBIC investor organizations should not be "affiliated" with a small business concern for the purposes of determining either the small concern's size or whether or not it is independently owned and operated. The organizations listed in the section are not operating companies seeking control of the small business for market segment purposes and thereby folding the small company into a large, product- or service-specific enterprise. Often, an SBIC can be the catalyst for a crucial round of shared financing for a small concern. This provision will help ensure that worthy small business concerns have the greatest possible access to the capital they need to continue to grow.

**9. Limited Liability Companies.** We applaud the addition of limited liability companies (LLC) as permitted business structures for the operation of an SBIC. In many parts of the country, LLCs are the preferred structure for venture investing and there are no safety and soundness or other qualifications that ought to preclude their acceptance in the SBIC program.

**10. Maximum outstanding leverage.** We believe that this is a good provision which will permit the SBIC program to grow in size as inflation affects the relative value of the dollar. It will not change the requirements for investing in small business concerns that meet the various and applicable size standards.

**11. Equity Capital Investment Requirement.** This provision is a needed correction. It will protect participating security SBICs from unintentionally being "out of balance" with respect to equity capital investments caused by timing or distributions of investment gains and not by failure to invest 100 percent of leverage in equity capital as is required.

**12. Examinations.** We believe it could be beneficial for SBA to contract out certain of its responsibilities if the quality and cost of the contracted services are reasonable. In this regard, we concur with SBA's request that it be allowed to use fees paid by SBICs for licensing and examinations in order to finance such contracts.

**13. Independent certification of valuations.** We do believe that current regulations are sufficient. However, we understand the thrust of the proposal and support what we believe to be the goals of the draft legislation. If the Committee wishes to go forward in this vein, we suggest that the requirement for an annual independent certification of value be changed to require an annual audit of such financial statements as may be required by the regulations. Included in the scope of the audit would be a review of valuation procedures and documentation. Independent accountants are bound by professional standards which prohibit them from certifying valuations.

**14. Book entry registration of certificates.** This is a desirable change which will permit the electronic processing of securities transactions. Current practice requires actual notations on the securities and physical delivery. This is costly, time-consuming, and not in keeping with the practices of today's securities industry.

**15. Fees.** We believe the fee and interest increases (a 3 percent commitment fee and a 50 basis point increase in interest on outstanding leverage) proposed in the draft bill are reasonable. In so stating, we assume that these increases will be applied prospectively to new leverage draws.

You have heard that the SBIC industry agreed that the fee increases proposed in the President's budget were reasonable and acceptable. We have testified previously that they are at the outside limit of the "reasonable" standard. Also, during the process that led to the June 1995 Report of the SBIC Reinvention Council, industry representatives agreed that a 100 basis point increase in the interest rate would be reasonable if the availability of adequate leverage were made certain. Since there is still a leverage shortfall with respect to debentures at the least, we believe a step approach is the best approach. More importantly, we believe subsidy rates will begin to fall dramatically as results from the improved SBIC program gain greater weight in the calculations. This is an important factor to focus on in the coming year. The cost of increased fees and interest is ultimately borne by either small business concerns or SBIC investors. Because of this, we think it prudent to raise costs slowly. We are approaching the point where greater increases will begin to curtail the desired growth of the industry, which would be to the detriment of the small business concerns we serve.

**16. Participating security characterization.** One issue not addressed in the draft bill which we recommend to you for consideration is that concerning the characterization of SBA-guaranteed participating securities as debt for underwriting purposes. If the Trust Certificates that represent interests in the pool created to fund the participating securities program are deemed to be equity securities, certain adverse tax consequences ensue and the Trust Certificates become unmarketable. Although SBA and the IRS have been attempting to find a solution to the problem, to date they have been unsuccessful. This characterization or definitional problem is substantial and may put the highly regarded participating securities program in jeopardy.

The following are provisions of the draft bill about which we have some concern.

**1. Definition of private capital.** Paragraphs a and b below are suggested changes while paragraph c represents a concern.

a. On page 2, line 21, we suggest inserting "and undistributed profits" after the word "capital." Undistributed profits of a partnership are akin to paid-in surplus and retained earnings for a corporate licensee.

b. On page 3, line 17, we suggest inserting the words "of any such bodies" after the word "plan." Although the section seems clear as written, we think it important to emphasize the permissibility for state, county, and local pension plans to invest in SBICs. As Congress has recognized, the plans represent the private interests of their beneficiaries and are, in reality, investing private capital.

c. With respect to the change in percentage of allowed nonprivate funds, we are not certain why the draft bill suggests moving from 33 percent to 20 percent. In certain states where private capital may be in short supply, but the need to support small businesses is no less important, the availability of additional qualified nonprivate funds may be of great importance. Notwithstanding the question, if the change becomes law, we urge the insertion of a clause indicating that the change is prospective in nature and does not affect either existing licensees or applicants of record as of the date of enactment. Significant time and money has been spent in reliance on the current rules and it would be inequitable to require a change after the fact.



**2. Third party debt and the SBA as senior creditor.** The provisions dealing with SBA's creditor status and third party debt are of substantial concern. Moving the SBA from a subordinated lender status (with powers to protect its interests as provided in the regulations) to senior lender status is a substantial and material change. At the least, the change may adversely affect bridge financing that is presently of critical importance because SBA funding is done on a quarterly basis. The current law and regulations represent years of working on complex priority issues and seem to strike a reasonable balance between the interests of Government and industry. While we concur with the objective to strengthen the SBIC program, we do not believe a change of this sort should be undertaken without substantial consideration by all parties as to the possible affects of the proposed change. We look forward to working with the Committee in this regard.

**3. Requirement to finance microenterprises.** The current provisions of Section 107.710 of the Regulations provide that, ultimately, 20 percent of total dollar financing be invested in "smaller businesses" as defined in that section. We support the regulation of ensuring that smaller businesses receive adequate financing potential. We are uncertain as to whether the draft bill intends a new requirement (a subset of the "smaller businesses") or not. We do feel the current requirement is reasonable and do not think a change is needed.

**4. Subsidy rate calculations.** We are uncertain as to the affect this change might have. If the intention is to create one fund to be allocated between debentures and SBICs, it is important to understand how that allocation will be made. If there would continue to be authorizations for both debentures and participating securities, we are not certain of the advantages that might be derived from the single subsidy rate -- for either Government, industry, or the small business community. Finally, for program evaluation purposes, it may be beneficial to continue the current practice of determining separate subsidy rates.

**5. Revocation of licenses for noncompliance.** We believe this section is meant only to address issues raised with respect to changes in minimum capital and licensing requirements proposed in the draft legislation. In that regard, we have previously made clear our feelings that adequate "grandfather" protection may be required in several places. If we are in error and the section is meant to be broader than that, it is of significant concern to us. A broad requirement to ratify or revoke all SBIC licenses as of that date would require more resources than we believe the SBA could muster and, as written, would provide no opportunity to cure operational defects that might be found in the ratification process.

#### **D. Conclusion**

In conclusion, we would again like to thank you for the opportunity to appear today. We are proud to be a part of the new and improved SBIC program and the good it is accomplishing for U.S. small businesses and the new jobs and technologies they create. We commend the committee for its desire to find ways to improve the program further and hope our comments have been helpful in that regard. As others in the industry, we stand ready to work with you to produce the legislation required this year to see the SBIC program grow towards its full potential.

Chairman BOND. Thank you very much, Mr. Dick. Let me reemphasize what I think I have said before. We do welcome your continuing comments based on discussions here. We are going to be taking into account all of the recommendations that you have put forward and will look forward to being in touch with you as these things develop.

Let me ask Mr. Granat and Mr. Jones if they have any further comments on Mr. Dick's discussion of the proposed raise in the placement fee, the interest rate surcharge. Mr. Granat, any other thoughts on that?

Mr. GRANAT. No, thank you.

Chairman BOND. Mr. Jones.

Mr. JONES. No.

Chairman BOND. The SBA has indicated that an SBIC projecting at 20 percent return on their portfolio investments would experience less than one-half of 1 percent reduction in return on total equity with the full 1 percent annual fee. Is that an unrealistic projection, Mr. Granat or Mr. Dick?

Mr. DICK. I think that the four-tenths of a percentage difference in the rate of return is probably accurate. I am not sure that the 20 percent projected rate of return is reasonable. I think it will depend—

Chairman BOND. Do not see too many of those deals coming around?

Mr. DICK. It is not the deal, it is the experience of the management team. My partners and I over the last 10 years have averaged 22.4 percent. But the industry, the venture industry—and this is where you are drawing your pool of managers—the median has got to be around 12 percent gross. So that is my fear.

Chairman BOND. Mr. Jones, what would you say the projected return on portfolio investment is?

Mr. JONES. Our projected returns and our experience over our 18 years in fact is above 20 percent. We are in unique industries where we can even make some mistakes and have the industry cover us. Telecommunications has done well, but I think we have learned and done well in the process.

But as mentioned, the venture capital industry at 20 percent projection is extremely optimistic and is not supported historically by returns in the venture capital industry. A realistic return, in the area of 12 to 14 percent is probably a good target. In fact, if you return that to limited partners, they are quite pleased.

Chairman BOND. I could imagine. In our proposal we have proposed raising the limit for private capital to obtain a new SBIC license. Several of you commented, particularly Mr. Jones, about existing SBIC licensees. Are there additional standards? Do you recommend that we grandfather existing licensees? How could we establish appropriate statutory safeguards for licensing people, SBICs who cannot make the minimum level?

Mr. Jones?

Mr. JONES. Statutory safeguards are difficult because you are dealing with people and judgment really in this industry. The SBA has criteria for accepting licensees and qualifying managers, and hopefully verifying their integrity which is really a function of very many things and it is hard to enact that into a statute. I think the

discretion should be left, as it is in almost all industries, certainly in the financial industries, as a basis of judgment, not statute.

The reality is that success really depends more on the integrity and the experience of individuals than it does on any statute or any capital size in this industry. That is just fact. I do not know what else to say. I just believe that either you trust the SBA's ability to make those decisions, and I think criteria, the level of standards has been raised and I think the abuses—

I know the former SBA associate administrator for this program Robert Stillman said in writing that 80 percent of the abuses in this industry really were a result of greed. They were not a result of licensing size, et cetera. It was integrity of people that is involved here. I do not know how you put that in statute other than requiring minimum standards that you expect your agency to monitor.

Chairman BOND. Mr. Granat, any thoughts on it?

Mr. GRANAT. I share some of Mr. Jones' thoughts. I feel that a grandfathering is appropriate when utilized with all the other standards that the agency employs in oversight of the quality and performance of a licensee. There should not be a retroactive adjustment that sends responsible, long-term players in this industry running for the hills having to either liquidate their companies or consolidate their companies when they have been performing well and doing a responsible job and meeting the needs of small business.

Chairman BOND. Let me turn to the SBA for a couple questions. The Administration's budget does not include a request for funds to provide additional SSBIC leverage. Could you share with us, Ms. Forbes, how the Administration arrived at the decision not to request funds for the SSBIC leverage?

Ms. FORBES. Yes. We did request it in fiscal year 1996. We received no funds for the program. The subsidy rate for the SSBIC leverage is significantly higher, possibly 10 times as high. If you give me a minute I will find the exact number for you.

Chairman BOND. You can submit that for the record. But the SSBIC leverage—

Ms. FORBES. It is 27.8 percent for the SSBIC debentures and 43.1 percent for the preferred securities. So it is simply a budget decision where we could get more bang for the buck out of the SBIC funding. Our proposal has the SBIC subsidy rate in the 3 percent range.

Chairman BOND. When did you get these subsidy rates from—is this from OMB? When did you get these?

Mr. CHRISTENSEN. That is for fiscal year 1995. The Administration did propose the inclusion of subsidized leverage in fiscal year 1996 and the Congress did not approve it. To understand the magnitude of the problem that Ms. Forbes referred to, if you take the \$21.7 million appropriation that the Administration seeks and if we were to use that at the 4 percent preferred level, which is one of the major components that finance the SSBICs, that would generate only \$50 million. By doing it in the SBIC program, with it not being subsidized, we get \$625 million. It really just becomes an issue of the economics.

The SSBICs are eligible for debenture financing. They could be eligible for participating securities financing. So we do not think that we have cut them off. We have just recognized the economics of the situation and require them to pay part of the cost of the leverage by not getting the subsidized feature.

Mr. JONES. Can I add a comment, Senator?

Chairman BOND. Please, Mr. Jones.

Mr. JONES. One, I think it is important to know that the rates, these higher rates, the subsidized rates are determined not by losses but by cost. In other words, because it is subsidized it results in a higher cost. It is a cost of funds issue, not a safety and soundness necessarily issue, or a historical loss issue. I think that needs to be stated.

The leverage was created for a reason. It was to incentivize—that type of subsidized leverage was created to flow capital to a certain marketplace. If that clearly is not in the national interest to do anymore, we accept that; that this marketplace does not need to have incentives to flow capital to it. I think you and I know that in St. Louis and other places it still needs it. Bill White and Johnny Roland who we funded, Ron Thompson who we funded, all of these people are good people who need capital.

So it is really a question of cost. And by the way, the funds that were authorized in 1995 were oversubscribed. So the need is still tremendously there for this kind—but it is not available anymore. We recognize it and we say, let us go over here to where capital is, but let us still incentivize capital to flow to this marketplace for good reasons.

Chairman BOND. Bill and Johnny and Ron still get capital if they need it. They are doing pretty well on their own.

Mr. JONES. They are doing well now. But when they started, that is how they started, with us. We funded them and they could not get capital.

Chairman BOND. You have got three very good people to bet on, I would have to say, knowing all of those—

Mr. JONES. A couple of them are good Republicans even.

Chairman BOND. I did not say anything about that.

[Laughter.]

Let me turn now to Senator Bumpers.

Senator BUMPERS. Thank you, Mr. Chairman.

Mr. Jones, I had been led to believe before today's hearing that the NAIC—is that the organization that you represent?

Mr. JONES. Yes, in addition to my fund.

Senator BUMPERS. I had understood that you were signing off, that the SSBICs had signed off on this proposal. I notice in your testimony you want additional time to comment on this; is that correct?

Mr. JONES. Had signed off on what proposal, Senator?

Senator BUMPERS. On this draft proposal.

Mr. JONES. No, not at all. We just received it a couple days ago and are analyzing it and have concerns about significant portions of it, sir.

Senator BUMPERS. Patty, on the \$2.5 million capital requirement, how many SBICs today would not meet that?

Ms. FORBES. One hundred and four.



Senator BUMPERS. Out of what, 170? How many do we have?

Ms. FORBES. I combined the SBICs and the SSBICs. I believe we have 268 combined. So out of 268—

Senator BUMPERS. One hundred and four would not qualify?

Ms. FORBES. That is correct, about 38 percent.

Senator BUMPERS. What percentage of the SSBICs would not qualify?

Ms. FORBES. It is about 80 percent.

Mr. JONES. SSBICs, approximately 76 to 80 percent, sir. Approximately 80 percent, we have from SBA the chart here; 58 out of 76 that are leverage SSBICs. It is about 75 percent, maybe 80 percent.

Senator BUMPERS. Patty, you say 104 would not qualify?

Ms. FORBES. That is correct if you count SBICs and SSBICs together.

Senator BUMPERS. Are those smaller ones inherently riskier than the bigger ones? Do they have a greater default rate?

Ms. FORBES. Of the 104 companies that would be affected, there are 17 that are on the watch list. The rest of them have been economically viable, and we would say they are not inherently riskier. Now in general, SBA has a rule that \$5 million is what we would expect of new licensees. But, if they have lower capitalization than that and can show why they would be viable, (maybe they are a bank-owned SBIC and they have been contributing some of their administrative costs) then there could be an exception made under our current rules.

Senator BUMPERS. How many SBICs with more capital than \$2.5 million are on the watch list?

Mr. CHRISTENSEN. Thirteen.

Senator BUMPERS. Not a significant difference then between those who are under \$2.5 million and those who are above it.

Ms. FORBES. I think that number is wrong. I think there are fewer than that on the watch list with capitalization over \$2.5 million. But of the 17, only 7 of them are there because of capitalization problems. The others are there because of regulatory or other sorts of problems. The reason they are on the watch list is not because they do not have enough money and they are not performing in that regard.

Mr. CHRISTENSEN. Senator Bumpers, the answer was that we have 17 with less than \$2.5 million, 4 are greater than \$2.5 million in terms of private capital.

Senator BUMPERS. Four?

Mr. CHRISTENSEN. Licensees that are on the watch list. Our watch list currently consists of 21 licensees.

Senator BUMPERS. Seventeen with less than \$2.5 million and four with more?

Mr. CHRISTENSEN. Yes, that is correct. But we include on the watch list other things besides financial parameters. In other words, regulatory or other concerns that we have about the long-term viability. Even though they have not reached the level of losses that would imply an impairment, we put them on the watch list to make sure they get closely scrutinized.

Senator BUMPERS. So the fact that somebody is on the watch list does not mean that they are in financial difficulty?

Mr. CHRISTENSEN. That is correct.

Chairman BOND. Let me just interject to clarify one thing that I had stated. I am not sure that SBA had addressed it, but I had been advised that 92 percent of the SBICs going into liquidation, 92 percent of the 125 licensees that were transferred to liquidation had private capital of less than \$2.5 million. In other words—

Ms. FORBES. What was the period of time?

Chairman BOND. Since 1989. Is that correct or am I misinformed?

Mr. CHRISTENSEN. I do not know exactly where you got those particular numbers. Of the 186 companies that are in liquidation today, 78 percent of them had capital of less than \$2.5 million. But I think what that is reflecting is the fact that, if you have an inexperienced SBIC we typically would not license them with less than \$5 million. What has happened is that the risky ones have been worked out and have gone into liquidation, and the balance of the portfolio that we have of smaller SBICs are, by and large, extremely viable from an economic point of view.

Chairman BOND. Thank you. The statistics we had came from a January 31 letter.

Excuse me, Senator Bumpers. Please go ahead.

Senator BUMPERS. If we blend the subsidy rate, Patty, will that have any impact on our ability to keep up with each one of those programs?

Ms. FORBES. I guess it would depend on how it was done, but I have been advised by OMB that they would not support blending when—typically, under Credit Reform if there are program differences and/or significant risk differences OMB would prefer to have separate subsidy rates to keep track, just what you were saying, to make sure you can keep track of how the performance in each program is progressing.

Senator BUMPERS. Would we even be permitted to do that under the Credit Reform Act?

Ms. FORBES. I have been advised there would be no statutory prohibition.

Senator BUMPERS. This proposal would index the maximum \$90 million leverage for inflation. How many SBICs do we have that meet a \$90 million criteria?

Ms. FORBES. We do not have any that meet it at this point. I think our highest is \$78 million.

Senator BUMPERS. On the 90-day application, I do not have any quarrel with that from a sort of political standpoint, or really from a business standpoint. I think the Government ought to give people answers. I allow my staff to occasionally inquire as to the status of something and perhaps find out when a constituent can expect an answer. We always try to be extremely cautious about that, to let whoever know that it is a certified, genuine question about the status of something and not an attempt to put pressure on them or make a judgment one way or the other, which is the best way in the world to get before the Ethics Committee.

But we do occasionally do that when we feel that people are entitled to an answer. A lot of people are out there hanging by their thumbs waiting for a decision, and I am sure everybody at that table understands what I am talking about. But I am not sure that



an arbitrary period of 90 days—do you all have some kind of a regulation on that right now?

Ms. FORBES. We do not have a regulation on it, no.

Senator BUMPERS. You just do it as expeditiously as you can?

Ms. FORBES. That is right.

Senator BUMPERS. What is the normal rate of time it takes to license?

Ms. FORBES. It often depends on the applicant, and it depends on how much additional information we have to receive from them. Right now I think it is about a year, which is a long time, and we are trying to speed that up.

Senator BUMPERS. The average is what now?

Ms. FORBES. About 1 year; 9 months to a year.

Senator BUMPERS. You can do better than that, could you not, Patty?

Ms. FORBES. Yes, we are trying very hard to do better than that. I do not think setting a 90-day deadline on it is helpful. We would certainly have to put more resources on it. What would probably happen is there would be a lot of debate over whether what was submitted was a complete application. If we can get completed applications, then obviously it speeds the time up.

Senator BUMPERS. Mr. Chairman, it seems to me that if we are going to go with a 90-day period or even a 120-day period we probably ought to have some sort of a caveat in there so that if they really need additional time because they are checking out some past conduct on the part of the applicant, they should have time to do that. It is always a terrible thing to license somebody and then find out that you have been a little too hasty and have given it to the greatest scam artist in America or something like that.

Chairman BOND. That ruins your whole day.

Senator BUMPERS. It will. You should have been Chairman of this Committee back when we started uncovering all these SBIC problems.

Chairman BOND. I am glad you cleaned it up before we got here.

Senator BUMPERS. As a matter of fact, a lot of this bill tracks the regulations that were promulgated as a result of those hearings.

Mr. Granat, on the Government seniority debenture, Section V of the bill gives the Government a senior position on SBIC debentures. At present they are subordinate. From the Government's viewpoint, and frankly from mine, I sort of like this, because we have had difficulty with bankruptcies. We found that we were at the tail end of the line. Would that affect your ability to borrow or to operate?

Mr. GRANAT. I think you have to look at it in different segments of the issue. As a general response to your question, yes, absolutely. But let us take the pieces of it. First of all, in commercial lending, I think a lender wants to know that he or she has the ability to evaluate a credit, make a loan, and determine on a periodic basis whether the lender wants to renew that loan or not based upon the merits of the borrower.

What we are introducing here, what is being suggested is a potential of a subjective injection of decisionmaking that is going to affect the commercial lender because of the agency—what is being proposed is the agency's ability to say no, that loans cannot be re-

newed. I cannot see a lender going into a credit with that kind of cloud overhanging.

The second observation that I would make, and I would ask this Committee to take a look at it, is the issue of secured debt versus unsecured debt. I think that certainly there is appropriate need for limitation on secured debt because securitization, whether it be in assets that we may have in our portfolio that collateralize loans, whether it may be in 100 percent of the stock of a company that is being held as collateral, or whatever the assets may be in the portfolio should be for the benefit of, primarily of the Government.

By defining the legislation as it relates to securitization versus the whole issue of seniority, I think hopefully you could come to a better solution than what is being proposed now. Because I would venture an educated guess that if the legislation as it is worded currently—and I would be interested, Walter, in your agreement or disagreement with that—if it is adopted I think you will be pulling the rug out from underneath an enormous segment of the industry with some of the best players in this industry, some of the best capitalized players who utilize bank lines for bridging between Government financings and for a modest additional leverage based upon the merits of their financial condition.

Senator BUMPERS. Mr. Dick, do you want to add anything to that?

Mr. DICK. I was just going to add one thing. I think you made the statement that currently the SBA is a subordinated creditor and I am not sure that is always the case. If you look at the language in the act it said that the SBA generally is subordinated unless the Administration in their own, I believe the word is discretion, determines otherwise. So to have a lender come into a senior position above the SBA is not clear cut. If I were a lender I certainly would want to get a clear-cut subordination agreement with the SBA before I put any money into any SBIC.

The way the act is worded, it is just not clear enough. So I think it forces most banks or other senior lenders to SBICs to put in place subordination agreements—and maybe, Patty or Don, you can tell us how many requests you get for subordination agreements because the act is unclear on that particular aspect.

Senator BUMPERS. My time is up.

Chairman BOND. I am going to turn this back to you and I am even going to give you the gavel so you can go on. I have got three quick questions I have got to ask before I need to run, and I appreciate your indulgence.

Let me ask the SBA, are you currently approving additional leverage for licensees who do not have the \$5 million in private capital and, therefore, would not qualify as new license applicants under your current licensing guidelines?

Mr. CHRISTENSEN. Yes, we are. The regulations that we are working under limit it to \$2.5 million. In other words, we do not approve leverage for anyone that has less than \$2.5 million unless they meet certain earnings tests. That is, the ones that Patty talked about.

Chairman BOND. Would you submit for the record the information on the number and the conditions under which you do it?

Mr. CHRISTENSEN. Yes, sir, be very pleased to.

[In further response, Mr. Christensen submitted the following:]

## U.S. SMALL BUSINESS ADMINISTRATION

INVESTMENT DIVISION  
409 THIRD STREET, SW  
WASHINGTON, DC 20416



JUN 18 1996

Honorable Christopher S. Bond, Chairman  
Committee on Small Business  
United States Senate  
Washington, DC 20515

Dear Chairman Bond:

At your May 10 hearing on the Small Business Investment Company reform legislation, you requested that I provide for the record information on the number and conditions under which SBA has granted leverage to licensees with private capital of less than \$2.5 million.

Attached is a schedule of the eight debenture fundings which SBA has held over the past two years, indicating the private capital for each licensee issuing debentures. I have not included data on the participating security fundings since in every instance private capital exceeded \$2.5 million.

You will observe that of the 75 fundings listed, only 21 were to licensees with less than \$2.5 million in private capital, and this involved only 17 different companies. Seven of these fundings were roll-overs of maturing debentures.

As to the financial conditions of the 17 companies, 10 had no capital impairment whatever, 4 had nominal capital impairments of 6% or less, and 3 had capital impairments of 7 to 18%, one of which involved a roll-over funding. (Under SBA regulations, existing licensees which did not meet the minimum capital requirements were permitted a one-time rollover of debentures maturing prior to December 31, 1995. The other two licensees were then operating profitably.) Prior to granting the leverage, the Investment Division's Credit Committee reviewed the financial condition, operating history and future prospects of each. These 17 companies represent less than 6% of the \$251 million disbursed in the fundings, and the 3 with significant capital impairments represent less than 1%.

If you desire additional detail on these licensees, I will be happy to provide it.

Yours very truly,

Don A. Christensen  
Associate Administrator for Investment

The attachments provided with this letter are not reprinted due to the confidential nature of the information, disclosure of which is prohibited by the Privacy Act.

Chairman BOND. Next question, I am informed there are some problems brewing with the IRS in their tax characterization of the participating securities pass-through certificates. If that is not straightened out, all the good work that Senator Bumpers and others accomplished in the 1992 statute is going to be a real problem. What is the status of that brouhaha?

Ms. FORBES. We are working with IRS. The Administrator has just sent a letter to the Commissioner of IRS and we have also notified the NEC and they are trying to work with us, too. So hopefully we will have a resolution shortly.

Chairman BOND. Do you think you can do it—are you going to need legislation?

Ms. FORBES. I cannot answer that at this time although it is possible.

Chairman BOND. Do you have any friends on the Finance Committee?

Senator BUMPERS. Not at all.

Chairman BOND. I do not either.

[Laughter.]

That is the problem, being appropriators, we do not know anybody. Maybe we can find somebody who has got some connections over there.

Finally for the SBA, if our bill allowed the SBA to use licensing and exam fees for program purposes could you retain the contract services of qualified experts to help you do licensing reviews and annual examinations so SBA staffing budgets would not be a limitation on the future growth in the number of licensees? Is that a way to get around it?

Ms. FORBES. It would be very helpful. We understand, though, is that to do that would have PAYGO results. So it might be a little difficult to do. But it certainly would help us. We have not been able to complete the study on which of those things you mentioned is cost effective. Obviously, we would want to do it if it were cost effective.

Chairman BOND. Thank you.

Mr. GRANAT. Mr. Chairman, excuse me. May I just make one point before you depart?

Chairman BOND. Please.

Mr. GRANAT. I think that it is important, and I hope I speak for everybody that is here today at the table, that we urge for the record the adoption of the \$225 million and \$400 million appropriation levels that have been suggested as a minimum. Thank you for allowing me to say that.

Chairman BOND. Thank you very much, Mr. Granat. Now I will turn this back to——

Senator BUMPERS. Mr. Chairman, just before you leave, on a separate subject. Are we going to do something with Ms. Lew on the 22nd?

Chairman BOND. Yes. We hope to——

Senator BUMPERS. Small Business Month is next month and I was hoping we could get her——

Chairman BOND. We hope to have all this come together on May 22. Given the in-depth nature of the comments, it is going to be a scramble to get it done. But we hope to get all this done on May



22 because this bill that we are talking about, we are going to have to have something in place when the appropriations hits because they are interrelated. That is why May is such a critical month.

But with that, if you will excuse me, I will turn this over to you.

Senator BUMPERS. Mr. Chairman, let me just say, I am prepared to adjourn the hearing. I just want to issue an invitation to each of you to elaborate further on any portion of this hearing or anything you think we need to know before we start marking this bill up.

Patty, I will just invite you over to the office someday and we will go over it together. Most of you know, Patty worked for me for several years and she is top-notch. I value her opinion very highly. So you and I can just have lunch someday, Patty, and discuss this because this is a fairly severe departure from the way we have been doing business. I am not absolutely sure I am going to support this. I think I certainly can support the lion's share of it. I hope that the differences that we may have can be resolved. Senator Bond and I have an excellent working relationship, and I think we can.

We only have one SBIC in Arkansas, so my staff tells me, and they would be torpedoed under this legislation. Based on the Whitewater case, I would just as soon not have any more SBICs in Arkansas.

[Laughter.]

But it is a good program and has served the Nation well, and we want to keep it viable. This thing about the prioritization of credit, that is always a knotty problem. Those of us who sit on this side of this table want to protect the Government's interest.

Jack Brooks and I used to fight, really through our staffs mostly, over bankruptcy and where we were in the pecking order of creditors when SBICs took bankruptcy. For some reason or other, Jack never really much wanted the Government to have a very high position on that. I understand that this does limit your borrowing ability. So maybe we can find some happy medium there where I will feel that the Government is as well-protected as we can be without interfering with your ability to borrow.

Mr. Jones, we need to know essentially, if there is a consensus among SSBICs about this legislation. We need to know that, and at a fairly early time as you heard the Chairman say. Mr. Dick, Mr. Granat, I know that you have additional points that you would probably like to make and you should address those to Senator Bond and me for our personal attention. We are most anxious to hear anything further you have to say about it.

Patty, as I said, you and I will just sit down and have a visit about this bill.

If we are going to markup on May 22, we need to really get cracking on it, and we would appreciate your comments at the earliest possible time.

Mr. Dick.

Mr. DICK. Senator Bumpers, we would like to thank you and your staff and Chairman Bond for the amount of work you have done on the legislation. A lot of the changes that were described were very positive, so we appreciate that.

Senator BUMPERS. Thank you.

Mr. JONES. Senator, in 1989 you authorized preferred stock repurchase funds to be used for refinancing SSBICs' subsidized debentures. We want to work with you to make this happen. What I am talking about here is the preferred stock buy-back program has generated some \$27 million in funds that could be used for rolling over debentures that are coming due by many SSBICs. In fact, this is a looming issue and potential time bomb because what is going to happen when these debentures come due.

We think this is a source of capital already available without budget impact that should be, can be, and I believe you in 1989 authorized it to be used for these one-time unsubsidized rollovers. We would like to get back to work with you on that, sir.

Senator BUMPERS. Mr. Jones, incidentally we may be related, my mother was a Jones.

Mr. JONES. I am from that area actually.

[Laughter.]

Senator BUMPERS. Mr. Jones, I am especially interested in the capitalization requirements, and the impact that it is likely to have on the members of your organization. Any comments you might have on that? I mean, the idea that—did you say 87 of them?

Mr. JONES. Well, 80 percent of the licensed—

Senator BUMPERS. Eighty percent would be taken out.

Mr. JONES. Would be wiped out, absolutely.

Senator BUMPERS. That would be a devastating blow.

Mr. JONES. The effect, even unintended, on the minority business in this country would be devastating. I do not understand the political or social or economic reasons for it, if in fact as Ms. Forbes and Mr. Christensen have indicated, those funds are operating successfully in the main. It just does not seem to make sense.

Senator BUMPERS. I do not think there is any direct, total correlation between the capitalization and how well they are doing.

Mr. JONES. Absolutely correct.

Senator BUMPERS. The idea of torpedoing all of those just because of some arbitrary figure, of course, is unacceptable to me. That is the reason I want your comments and your thoughts about this.

Mr. JONES. I really believe it potentially undermines this entire program, and people who support that are participating in their ultimate demise because someone sooner or later in this country is going to say, why are we financing large venture capital funds with public dollars to compete against, as I have a chart here to show you, the average venture capital fund which is only a \$50 million, a private venture capital fund.

Senator BUMPERS. One other thing we did not discuss this morning, and that is the diversification of ownership. I do not know how dramatic these changes are, but any of you, particularly Mr. Dick and Mr. Granat, if you all have any thoughts about that I would like to have them. You have got to have three shareholders, limited partners or members or at least one institutional investor that is not associated with the SBIC and is an entity regulated by the Federal or State Government. I do not know how that compares with the present requirements, but I think that is a significant departure. Is it?

Mr. DICK. I do not believe it is.



Ms. FORBES. No.

Mr. DICK. I think it just is codifying the existing rules and regulations. Senator Bumpers, I would like to make a comment on Mr. Jones' testimony about the average venture fund being \$50 million. The new venture fund average may be \$50 million, but it often is being managed in conjunction with one or two or three other funds. The average capital under management, at least in New England, we took a poll of the number of firms that were managing in excess of \$75 million and over the last 4 years that dropped from 66 firms to 24. So the average total assets are the key measure—I do not think we are creating a counterpart or a competitor to the venture capital industry by doing what we are doing in the SBIC program. That was my only point.

Senator BUMPERS. That is a good comment.

Mr. JONES. The point though is, regardless of how many funds under management, each discrete fund's investment policies and amounts of size of investments is determined by the size of capital in that fund. If the average fund is \$50 million and one assumes that in a venture fund one would do 15, 20 deals maximum responsibly, would you agree?

Mr. DICK. I think it depends on the circumstances and the number of partners.

Mr. JONES. You are not going to do 50. The fund typically, most funds do in an investment 5, 10 percent of their capital per investment. So you are talking about in that size fund a \$2 to \$3 to \$4 million target investment size. I do not care if you have six funds under management with \$500 million in capital, each fund's investment size is targeting the businesses that this program is being moved toward.

That is funds, as you mentioned, the capital coming into this industry in the last couple of years with new licensees averages private capital of \$15 to \$17 million. One tier of leverage makes you \$35 million. Two tiers of leverage makes you \$60 million or so. You are talking about you have recreated an industry that exists. My point is, the public support for this program is because it serves an underserved or an imperfection in the marketplace. I do not think you can support that when you mimic and create funds and support funds with policy with public dollars that are of the same size and do the same size investments.

Senator BUMPERS. We would appreciate receiving your comments at the earliest possible time. We will stand adjourned.

[Whereupon, at 11:14 a.m., the Committee was adjourned.]

**APPENDIX MATERIAL SUBMITTED**

PREPARED STATEMENT OF SENATOR CONRAD BURNS  
SENATE COMMITTEE ON SMALL BUSINESS  
MAY 10, 1996

Mr. Chairman, I'm always happy to join you in trying to improve an existing program. Today is no different. After looking over the proposed reforms of the SBIC, I'd say you're right on the mark.

With fewer dollars available in the federal coffer, we need to find ways to make each dollar go further. Though the fees may be slightly increased, I am amazed that we end up making more dollars available with less appropriations than last year. I wish we could do that in other areas as well.

It is my understanding that the majority of this bill simply puts into statute some of the practices already being followed. So, though these may be new rules on the books, they are not new in the industry. And I think that's important to point out.

I'll keep my remarks short, because I'm more interested in hearing from our witnesses here today. They are the ones that must implement these reforms, must shoulder the burden of the rate changes, and must live with the results. Their input is vital. I believe Montana only has one SBIC, but you can bet I'll be floating these proposed changes with them as well.

Thank you for holding this hearing, Mr. Chairman. I look forward to working with you to improve the SBIC program.



U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, D.C. 20416

May 20, 1996

Honorable Christopher Bond  
Chairman  
Committee on Small Business  
United States Senate  
Washington, DC 20515

Dear Chairman Bond:

Thank you for permitting SBA the opportunity to make other comments on the Committee's draft bill on the Small Business Investment Company (SBIC) Program as a follow-up to our hearing on May 10.

**KEY ISSUES**

The Agency has two general concerns about the Bill:

1. *The retroactive nature of many of the provisions.* The Agency would like to avoid resurrecting the old perception that the government is not a dependable partner, in terms of either its regulation of, or its commitment to, SBICs. We believe that such a perception would make it more difficult to attract the qualified management groups that are most desirable as licensees.
2. *The advisability of legislating policies which are currently being handled successfully by regulation.* Since the Agency believes that these matters are now being successfully addressed within the regulatory framework, codification could reduce the flexibility necessary to tailor the application of such regulations to individual unique circumstances. Unfortunately, if regulations are explicitly legislated, a serious flaw would be difficult to change and responsiveness to prospective problems would be made more difficult. Additionally, the Office of Management and Budget advises that such policies, because they are currently in effect, have been fully credited in the 1997 subsidy rates.

**THE ADMINISTRATION'S BUDGET PROPOSAL**

With respect to fees, the difference between those proposed in the President's FY 1997 budget and those proposed in the Bill is a one-half percent (50 basis points) markup to the Debenture or Prioritized Payment interest rate. For an SBIC that achieves the target 20% return-on-investment achieved by funds such as those managed by Mr. Walter Dick who testified at the May 10th hearing, this would

reduce the gross internal rate of return by only 40 basis points, from 29.74% to 29.34%. The Agency feels that this is a very small investor price for SBICs to pay in order to save the government \$14.1 million in appropriations, were a 100 basis point markup to be implemented rather than the 50 basis point proposed by the Bill.

The Agency would encourage having any change in leverage fees become effective as soon as possible so that the reduced subsidy rates can be applied against any uncommitted balance of the FY 1996 appropriation.

#### **MINIMUM CAPITALIZATION**

The history of the program has demonstrated that insufficient capital can lead to future losses. The existing general minimum requirements of \$5 million for a Debenture license and \$10 million for a Participating Securities license recognize the need of an SBIC to be well capitalized and to be able to afford the experienced, professional management required for proper investigation of proposed investments and to perform adequate oversight once an investment has been made. However, SBA does recognize that under some limited conditions, for example, where an SBIC's overhead is low because of special circumstances, that lesser amounts (\$2.5 million for Debentures and \$5 million for Participating Securities) may still constitute adequate capitalization. Exceptions to the general requirement are necessary to cover licensees that address underserved markets. An example is the case of the North Dakota Small Business Investment Company, L.P., where SBA granted a participating securities license to a community sponsored applicant with just over \$5 million of private capital. This licensee demonstrated special circumstances which reduces its overhead because: (1) it is being managed by an existing SBIC located in Cedar Rapids, Iowa which can co-invest with the North Dakota firm; (2) the geographic region being covered is relatively small which reduces overhead expenses; and (3) operating expenses in Fargo, North Dakota are lower than elsewhere.

The Agency strongly opposes the Bill's requirement that SBICs with private capital of less than \$2.5 million exit the program. Under the draft Bill's provisions, 104 SBICs, or 38% of all current licensees would be required to cease operations. This group represents \$132.7 million of private capital and \$189.5 million, or 17% of outstanding SBA-guaranteed leverage. The vast majority of this group have demonstrated long term economic viability,

Of these 104 licensees, 85 have outstanding SBA leverage with terms established by contract. This leverage has up to 10 years remaining until maturity for debentures and up to 15 years for 4% preferred stock. The 3% preferred stock presents special problems since it has no stated maturity at all. While the stated objective of this provision is to reduce the SBA's administrative workload and to address concerns regarding possible future losses, SBA's experience indicates that

forced premature liquidation would dramatically increase SBA's oversight demands for many years to come, and would result in greater losses to the government in recovering outstanding leverage than would a more orderly wind-down.

At the present time, before any new leverage is granted, SBA addresses the credit risk associated with each licensee by requiring a careful credit review. A continually updated "watch list" is utilized to monitor troubled situations and to provide early identification of possible failures. Furthermore, current regulations prohibit SBICs with less than \$2.5 million in private capital (\$1.5 million for SSBICs) from obtaining new leverage unless they have been profitable for three of their last four fiscal years and, on average, have been profitable overall for all such fiscal years. Licensees that do not satisfy these criteria may refinance existing debentures as they mature on a one-time only basis, only if the credit committee judges that renewal has the benefit of reducing potential future losses.

The Agency believes that existing policies adequately protect SBA against unnecessary losses and that a statutory provision is not needed.

#### ***SPECIALIZED SBICs (301[d] Investment Companies)***

The proposed legislation deletes Section 301(d) of the Act and eliminates all references to program features unique to 301(d) licensees. While this is consistent with the proposed recommendations of SBA's Specialized Small Business Investment Company Advisory Council to merge the 301(d) program into the 301(c) program, the Agency does not believe that existing 301(d) licensees should be legislated out of existence. Additionally, the Council believed that certain benefits such as priority in times of insufficient program level should be extended to SBICs that meet the public policy purpose of lending to businesses owned by economically or socially disadvantaged persons.

To the extent that previous 301(d) licensees join the Bill's Smaller Business Investment Company program (i.e., SBICs with at least \$2.5 million, but less than \$5.0 million of private capital), they will utilize their resources to address a broader but still underserved market. However, in fairness to smaller licensees which have served the 301(d) program for many years but do not qualify for the Smaller Business SBIC program, and to protect SBA's creditor interests arising from their leverage, they should be treated the same as existing 301(c) licensees.

Regarding the elimination of the 301(d) program, it will be necessary to address the implications of the proposal on those licensees that have participated in the 3% preferred stock repurchase program which, among other things, requires continued active investing for a period of five years.

We have also been advised by OMB that there may be tax implications. As you may be aware, Section 1044 of the Internal Revenue Code provides favorable tax



treatment for investments in SSBICs by allowing investors to roll over capital gains if they reinvest the proceeds in an SSBIC. The investors can postpone the tax liability they otherwise would incur when selling assets with accumulated gains. This Tax Code provision would not work if the SSBIC designation were eliminated. The legislation should probably be referred to the Finance Committee since it affects a Tax Code provision.

### ***SIZE STATUS ISSUE***

In providing that investments by venture capital type firms in an otherwise small concern shall not affect the firm's size status determination, the Bill appropriately addresses a situation which now adversely impacts the investment program of a number of licensees, especially those which issue participating securities. SBA is preparing to address the issue on a regulatory basis, but legislative redress would be appropriate since it concerns a fundamental program precept — the definition of what constitutes a "small business" eligible to receive SBIC financing. The Agency would be pleased to offer technical assistance in the drafting of this section.

### ***DIVERSITY OF MANAGEMENT AND OWNERSHIP***

A cornerstone of regulatory change has been the requirement that all new SBICs have owners who are not managers and that these owners have at least 30% ownership in the SBIC. This means that SBIC managers then have a fiduciary responsibility to outside investors, which increases oversight, and inhibits utilizing the SBIC as a personal investment vehicle to the detriment of SBA. The Agency believes that this concept represents a fundamental strength of the new SBIC program. However, the Agency suggests that general language be included in the Bill, rather than the specifics in the draft, with implementation governed by SBA regulations.

### ***MAXIMUM LEVERAGE***

The Bill proposes that a licensee's maximum leverage eligibility be indexed from the \$90 million established in 1992. In light of continuing budget pressures, it is the Agency's view that, both from a risk and from a public policy purpose, that the maximum should be reduced to \$60 million at this time. The Administration will review the proposal to index the maximum leverage eligibility.

Larger firms tend to make larger investments. Venture partnerships, regardless of size, usually invest in 20 to 30 companies during their lifecycles. There is already an established private venture capital industry of firms with capital in excess of \$100 million whose typical investment size is \$5 million or more. The financial market need that the SBIC program seeks to address is for investments in the

\$500,000 to \$5 million range which are typical of smaller venture firms. Since SBIC regulations limit the maximum investment to 20% of capital, or \$6 million in the case of a licensee capitalized at \$30 million, \$90 million of total assets is considered entirely adequate for a firm making investments in the desired size range and is consistent with current program funding levels.

#### **SUBSIDY RATE CALCULATION**

While the Bill proposes a single blended subsidy rate for the Debenture and Participating Securities Programs, it is the Administration's interpretation of the Federal Credit Reform Act that programs having significantly different features and/or risk should have separate subsidy rates. Under these circumstances, it is necessary to utilize two different mathematical models to compute subsidy rates since the two forms of leverage have quite different payment terms. Debentures have mandatory semiannual interest payments and participating securities have quarterly deferred prioritized payments plus a profit participation.

The Bill requires that all fees, interest, and profits that are directly related to the provision of leverage be included in the subsidy rate calculation. This would change the practice since 1986, which provides for certain costs directly related to SBIC leverage to be paid from the leverage fee. Currently, roughly 10 percent of the leverage fee is used to cover costs related to each funding, such as printing, legal, fiscal agent, selling agent, trustee, servicing agency and service. If this portion of the user fee is not available for these funding expenses, such expenses must be paid out of the Agency's limited salaries and expenses budget. The administration believes that the current funding structure is appropriate, and we therefore oppose this provision. This provision would simply transfer Federal resources from one budgetary account to another, and result in no savings to the taxpayer.

#### **SBIC LICENSING**

The experience of institutional investors in the private venture capital industry has demonstrated that *the initial decision to invest in a particular venture firm is the most important single factor in the ultimate success of their investments*. In other words, for institutional investors, venture investing is known as a "one-decision investment". Once the decision to invest in a firm is implemented, there is very little that the institutional investor can do to affect the ultimate investment results.

This experience is analogous to SBA's decision to license a particular SBIC, and accounts for the strengthening of the licensing process during the past two years. While SBA does have somewhat more control following licensing in limiting its financial exposure by ceasing to advance leverage and in insuring that the program's public policy objectives are observed, SBA considers licensing to be the most important risk reduction factor in the entire program administration.

As a result, SBA has developed a highly detailed and deliberative procedure for licensing which involves extensive "due diligence" evaluation of the qualifications and experience of the management team as venture capitalists, together with a detailed analysis of the proposed business plan. In addition, an assessment of the need for the license, and a legal review of its structure and organization is performed.

Each one of these activities takes considerable time since it requires a number of interactions with the applicant involving clarification of information and modifications of the license application in response to SBA's programmatic and legal comments. In addition, in many cases, the applicant or its attorney may have been unresponsive to SBA's requests, even after many months have passed. Setting an arbitrary time limit on processing a license application, such as the 90 days contained in the Bill, not only does not provide for the flexibility required in the day-to-day application process, but could result in hurried decisions that could lead to significant future losses. Permitting the Agency to use licensing fees to pay for licensing activities would be considered spending authority from non-Federal sources; and as such, would be a way of ensuring that sufficient resources could be devoted to the licensing activity when there are peaks in applications received.

During the past year, no SBIC application approvals were deferred based upon leverage availability (or lack thereof).

#### ***GOVERNMENTAL SOURCES OF PRIVATE CAPITAL***

The Bill reduces to 20%, from the current 33%, the amount of funds from Federal, state or local government sources that can be included in a licensee's "private capital". The 1992 legislation established the 33% limit, and since this provision has not resulted in any abuses, the Agency questions the need for a reduction. The current requirement that two-thirds of the capital be contributed by totally private sources should be sufficient to provide validation of management.

#### ***THIRD PARTY DEBT***

The Bill classifies third party debt as any debt other than debt owed to the Administration. The Agency believes that this definition is overly broad. It could include trade obligations such as payroll or copier leases, as well as debts incurred in the ordinary course of business. The Bill goes on to require written approval of the Administrator before a licensee may incur any third party debt or refinance any debt with third party debt and sets out a number of general considerations for granting approval. It also states that the Administrator may not grant approval if it "would subject any assets of the licensee to creditor claims to an extent that creates or contributes to an unreasonable risk of default or loss to the United States." Such approvals would be burdensome and time consuming and add considerably to

SBA's work load. Since the enactment of the 1992 legislation, SBA has carefully crafted regulations addressing the issue of third party debt. They seem to be working well, and would seem to obviate the need to address this issue legislatively. If, however, the Committee believes legislation is required, the Agency would urge a definition of third party debt that more closely tracks SBA's existing regulations.

#### ***PENALTIES FOR NONCOMPLIANCE***

The Agency has been requested to advise the Committee as to whether any additional statutory language is necessary to establish administrative or criminal liability for false statements and certain serious regulatory violations by SBICs.

In general, penalties for false statements made with respect to the SBIC program are set forth in the Small Business Investment Act (15 U.S.C. 687(c)-(h)) and the Federal Criminal Code (18 U.S.C. 1014). However, in the liquidation area, it would be useful to have legislative amendments clarifying that SBA is included in the scope of the civil penalties provision of FIRREA (18 U.S.C. 1014), which has a ten year statute of limitations. This would provide an alternative, plus an additional avenue of redress for enforcement of remedies against persons or entities making false statements to the government. The Agency would be pleased to work with the Committee in crafting an appropriate provision.

A second area where civil monetary penalties might be usefully legislated is with respect to general regulatory violations where currently available remedies tend to be too severe for some of the programmatic infractions which occur. Again, the Agency would be pleased to work with the Committee in crafting appropriate provisions.

#### ***EXAMINATIONS***

The Bill proposes to require that examinations "...be conducted with the assistance of a private sector entity that has both the qualifications to conduct and expertise in conducting such examinations". SBA has recently published a request for proposal for a study of examinations outsourcing. The Agency is seeking a contractor to perform 12 licensee examinations out of three locations including debenture SBICs, non-leveraged SBICs, and SSBICs. It is expected that the results of the study should be available and analyzed by the end of calendar year 1996, and SBA should be in a position to evaluate the possibility of outsourcing a larger number of examinations at that time. Until the Agency can assess the risks, benefits, and equally important, the cost effectiveness of using a private sector entity for examinations, the Agency believes it is inappropriate to legislate its use.

### **LIMITED LIABILITY COMPANIES**

At this time, the Agency has been informed by a number of sources that the predominance of venture firms being formed in California are limited liability companies. This form of business organization offers management and investors the limited liability benefits of a corporation and the asset distribution flexibility of a partnership. For the SBA, permitting such companies to be SBICs would simplify the licensing and administrative process since fewer business entities would be required in connection with each applicant that is licensed. SBA, therefore, supports this proposal.

### **TECHNICAL CORRECTIONS**

Finally, the proposed legislation addresses a number of technical issues which are generally desirable and non-controversial. These are:

- A. Clarifying the language in Section 308(e) that currently creates a potential conflict with Section 321 and Section 303(b), and seems to undercut the validity of the SBA guarantee of SBIC securities.
- B. Amending the language of Section 303(g)(4) to delete the words "and maintain".
- C. Adding statutory language to permit "book entry" registration and transfer of participation certificates. This will reduce the need for issuing paper certificates and will have the benefit of reducing costs of administering the program.

I appreciate the opportunity to offer these additional comments regarding your draft legislation, and look forward to working further with you and your staff to enact legislation to strengthen the SBIC program.

Sincerely,



Patricia R. Forbes  
Acting Associate Deputy Administrator  
for Economic Development

**COMMENTS FOR THE RECORD**





The Chase Manhattan Mortgage Corporation  
1400 East Newport Center Drive  
Deerfield Beach, FL 33442  
Tel 954-698-6999

**STATEMENT**  
**of**  
**CHASE MANHATTAN MORTGAGE CORPORATION**

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to present the views of Chase Manhattan Mortgage Corporation (CMMC) regarding the management of SBA financial instruments and their underlying collateral. CMMC has over twenty years experience in servicing a nationwide portfolio of mortgage loans. We service loans made by our own bank, we service loans made by other lenders who have assigned the servicing function to us, we service loans made by various state governmental authorities under housing and economic development programs, and we service a portfolio of rural housing loans made directly by the Rural Housing Service (RHS) of the Department of Agriculture.

Our purpose in presenting this statement to the Committee is simple -- to bring to the attention of the Congress that real and scoreable budget savings can be achieved if SBA will modernize its management of financial assets, utilizing the loan servicing and recovery expertise of the private sector. In terms of technology, experience, and asset management skills, today's mortgage servicing companies, who routinely service 48 million U.S. mortgage loans, can improve the performance of the SBA program and bring valuable savings to the taxpayer.

We also wish to draw to the Committee's attention one specific statutory factor which the Congress should address. A clause inserted in 1980 in the Small Business Act is interpreted by SBA as precluding any utilization of outside assistance in management or servicing of its direct loan portfolio. Although we are not sure that SBA's interpretation of this provision need be so absolute, the Congress ought to clarify, repeal or amend this provision (Section 5 b 7) to ensure that SBA has no reason to hesitate to utilize outsourced loan servicing expertise. As Administrator Lader has previously testified to this Committee, the SBA is interested in private sector servicing, having published a [Federal Register](#) request for ideas on this issue. A change in the law will encourage SBA to move forward.

Under any arrangement utilizing private servicing, the SBA borrower would retain all rights and protections. But, citing this clause of the Small Business Act, the SBA has not begun the reinvention and debt management initiatives already underway at IRS, HUD, and other Federal agencies with loan or debt portfolios. The Administrator's priority interest in government reinvention and customer service will be furthered by private loan servicing.

CMMC has a unique and very positive perspective on the advantages of private loan servicing. Since 1989, CMMC has been servicing approximately 80,000 RHS Section 502 low income housing loans in 47 states. The servicing rights to these loans were acquired as a result of the sale of the underlying loan portfolio by USDA in 1987. In this day and age when residential mortgage servicing has become a sophisticated and efficient business for hundreds of capable companies, and when at least one major servicer has a successful track record with a similar government loan portfolio, the SBA has no reason to hesitate or fail to recognize that private servicing will be more effective or efficient.

## **SUMMARY**

SBA should aggressively pursue service of its portfolio of direct loans with qualified private sector subservicers in order to achieve four advantages:

1. Better servicing will keep more borrowers in their houses and businesses, avoid defaults and foreclosures, and make the underlying program work more effectively. The borrower loses no rights while benefitting from the dedicated focus of experienced service based private sector professionals utilizing state of the art technology.

2. Servicing can be accomplished at a lower administrative cost outside the SBA, thereby freeing SBA to better meet the urgent demand for new loans.

3. Experienced private servicers will improve the currency of the accounts, better ensure constant collateral protection, and improve the recovery in foreclosure situations. These servicing improvements provide direct financial benefit to the government, which can be translated for budget scoring purposes to a lowered new loan subsidy rate. A lowered subsidy rate means program lending can be maintained at current levels at a lower appropriated cost.

4. Improved servicing will increase the value of the portfolio. This would create a new option for later consideration of an asset sale. In a sale of the portfolio, any premium between the actual price paid by private investors and the value of the portfolio as carried by the government can be scored as savings to SBA. CMMC's experience managing Rural Housing Service Loans from a 1987 asset sale, and the 1995 record of HUD portfolio sales, suggest that private servicing has a significant potential to improve the currency of the portfolio, increase its value to potential investors, and increase the sales revenue paid to the government.

#### **REQUESTED ACTION**

Congress should direct SBA to issue an RFP, soliciting specific proposals for servicing the direct loan portfolio. The RFP would specify that all legal conditions of the original loan and SBA servicing regulations apply, but should invite respondent proposals on improving borrower rights, customer communications, and reporting procedures.

The residential mortgage loan servicing industry is nationwide, technologically advanced, and highly competitive. SBA would likely receive many qualified and competent proposals, which will yield savings to the government and taxpayers.

**SBIC AND LOAN ASSET MANAGEMENT — BUDGET IMPLICATIONS**

The potential budget scoring impact makes private servicing and management of loans and collateral an especially timely issue. Greater reliance on outside loan and asset servicing can save administrative costs, savings which can be translated by the Congress into redeployed salaries and expense funding of other higher priority SBA projects.

But regardless of the extent of potential administrative savings, the most immediate benefit to the SBA of greater utilization of private servicing and asset management would be a greater return on the loan assets, resulting in a lower subsidy rate for the loan programs. Better loan asset management will mean that Congress can support the same level of financing to the small business community with less Federal appropriations.

**Lowered Subsidy Costs**

The subsidy rate calculated by the Office of Management and Budget is greatly affected by two factors, the interest rate environment and the management of the loan by the agency. For SBA guaranteed business loans and SBIC participating securities, the interest rate to the borrower is typically more than comparable Treasury securities. In the disaster loan program, the present interest rate is 4 percent. The subsidy rate can be lowered if the interest rate is raised. But with the 7(a) and SBIC loans already at market rates, and the Congress reluctant to raise disaster loan rates, raising interest rates to cut the subsidy may not be a viable option.

The other major factor in subsidy rates is the amount of money the Congress must appropriate to make the agency whole after it pays off the loans of those borrowers who default on their repayments. This is a matter of arithmetic. The more loans which default, the more funds the Congress must appropriate. The exact amount of the subsidy is influenced not only by the default rate (the number of borrowers who stop paying off their loans) but also by the recovery rate (the value of

collateral recovered after a borrower defaults). Naturally, the timing of these activities also influences the subsidy rate. If the collateral value of a defaulted loan can be recovered more efficiently, the time value of the lost funds is less than if the recovery is longer after default.

We believe the private sector can offer real improvements in each of these aspects of loan and asset management, improvements which will result in scoreable savings and a better program.

### **Improving Repayment Currency**

The number of borrowers who default is directly influenced by the quality of the servicing. When Chase took over servicing the RHS homeowner loans, it achieved a currency rate much higher than the comparable government serviced portfolio. The "secret" to this is application of technology, which better and more immediately collects and displays all related transaction records, consistent and clear servicer contacts with borrowers, especially troubled borrowers, and utilization of experienced borrower counselors whose job it is to keep borrowers current and avoid payment default. Mortgage loan servicers are not collection agencies. Their compensation is typically based on keeping a loan current and in repayment. Mortgage loan servicers have a financial incentive to keep borrowers current, and applying those incentives to service government loans can benefit the borrowers and the taxpayers.

Another important service provided by CMMC and other private servicers is ensuring the protection of collateral from uninsured losses or tax delinquencies. Our experience with the RHS portfolio showed that many payment defaults were triggered by action of local tax authorities, not by any underlying refusal of borrowers to pay. Working with borrowers to ensure collateral property protection is a normal part of our service, but we suspect not a service which SBA portfolio managers have sufficient time or expertise to deliver. Consistent collateral oversight prevents defaults and increases recovery rates.



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### Improving Collateral Recovery

In those cases in which default cannot be avoided, OMB statistics suggest that SBA is only modestly successful in recovering the value of the defaulted loan. The OMB Federal Credit Supplement states that the recovery rate on defaulted SBIC debentures and participating securities, as well as defaulted direct disaster loans, is only 50 percent. The SBA's historical average for recoveries on defaulted 7(a) loans is about 44 percent.

Such recovery rates are far below the norms for comparable privately serviced portfolios. An analysis by the Mortgage Bankers Association (MBA) reveals that the typical recovery rate on defaulted first position mortgage loans ranges from 80 to 90 percent. The MBA has also specifically analyzed recoveries on higher risk second lien mortgages, comparable to the SBA disaster homeowner portfolio. The typical recovery rate for servicers specializing in such loans ranged from 58 percent to the high 70 percent range.

### CONCLUSION

The results are clear. From a policy perspective, no loan should default. Private servicing can help keep more loans in repayment. If a loan does default, the government is collecting far less than private servicers. If the SBA does not look at the advantages of private servicing, then the message to taxpayers is that these government loan programs should not be expected to meet private sector standards. And more importantly, the Congress will have to appropriate more funds to support the programs than necessary if the private expertise were utilized.

The SBA performs an important function in making credit available to small businesses and disaster victims who cannot obtain the same terms elsewhere. This is an essential government function. Servicing such loans after they are made must be under SBA supervision and with SBA regulations, but is not a function that has to be performed by government in house staff. We urge the Committee to remove any statutory or procedural impediments and direct responsible use by the SBA of private asset management and loan servicing. The taxpayer, the borrower, and the SBA will all gain from this "reinvention" of government.





ISBN 0-16-053451-8



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